CHAPTER 1

Executive Summary

What This Study Is About

Managing the Crisis: The FDIC and RTC Experience examines the challenges faced by the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC) in resolving troubled banks and thrifts during the financial crisis of the 1980s and early 1990s. This study reviews the resolution and asset disposition strategies developed and implemented by the FDIC and the RTC in response to the crisis and describes the evolution of the methods used.[1] It also reflects on the effectiveness of these methods, as well as the lessons learned. This study does not discuss the reasons for the upsurge in the number of bank and thrift failures during this period, nor does it explore the regulatory responses to the crisis. Those issues are addressed in *History of the Eighties—Lessons for the Future: An Examination of the Banking Crises of the 1980s and Early 1990s*, a study that was compiled and published by the FDIC in December 1997.

This study is organized into six functional areas. The first area, Chapters 2 through 7, covers the evolution of the resolution process, including specific information on the use of open bank assistance (OBA), bridge banks, and loss sharing. The issues discussed in Chapters 8 through 11 are the receivership management process, including the FDIC's role as receiver, the closing process and payment of insured depositors, the treatment of uninsured depositors and other creditors, and the pursuit of professional liability claims. Chapters 12 through 17 discuss the asset disposition process, including an overview of the evolution of the asset disposition process and descriptions of the primary

1. The term "resolution" throughout this study means a disposition plan for a failed or failing institution. It is designed to (1) protect insured depositors, and (2) minimize the costs to the relevant insurance fund that are expected from covering insured deposits and disposing of the institution's assets. Resolution methods include purchase and assumption transactions, insured deposit transfer transactions, and straight deposit payoffs. A resolution can also refer to an open bank assistance plan provided to an institution to help prevent it from failing.

methods used, such as auctions and sealed bids, asset management contracting, securitization, partnership programs, and the Affordable Housing Program (AHP). The topic of Chapters 18 and 19 is internal operations, which includes the legal process and internal controls. Part II includes 10 case studies of significant bank resolutions. Finally, an appendix contains sections describing the legislation governing the FDIC's roles as receiver and insurer, statistical analysis over the period in the form of charts and graphs, and a glossary of frequently used terms and abbreviations.

Magnitude of the Problem

The U.S. banking and thrift industry in the early 1980s was facing a financial crisis of a magnitude not seen since the Great Depression years of 1929 through 1933, when depositors lost $1.4 billion with the closing of 9,755 banks.[2] The banking and thrift crisis of the 1980s and early 1990s bore certain similarities to banking conditions leading up to the Great Depression. With the notable exceptions of Continental Illinois National Bank and Trust Company (Continental), Chicago, Illinois, and the New York savings banks, the early 1980s bank and thrift failures were generally small institutions, many with roots in the agricultural or energy sectors. Continued problems in the energy sector and a collapse in several major real estate markets greatly increased the number and cost of failures. As a result, in 1988, the Federal Savings and Loan Insurance Corporation (FSLIC) insurance fund was reported to be at minus $75 billion, and the ratio of losses to all insured deposits rose to 1.48 percent, a level that had only been exceeded in 1933.[3] The insolvency of the FSLIC fund and the continued weakness in the thrift industry led to creation of the Resolution Trust Corporation in August 1989. Before that year ended, 318 failed thrifts had been taken over by the RTC.

How large was the problem? Between 1980 and 1994, 1,617 federally insured banks with $302.6 billion in assets were closed or received FDIC financial assistance. During this same time, 1,295 savings and loan institutions with $621 billion in assets also were either closed by the FSLIC or the RTC, or received FSLIC financial assistance.[4]

The failure of 2,912 federally insured depository institutions is equivalent to one failure every other day over the 15-year period. The combined total of $924 billion in assets from the failed institutions is equivalent to $168 million in failed bank or savings and loan assets that had to be liquidated or otherwise resolved each day for the 15-year period. The timing of the bank and savings and loan failures between 1980 and 1994, however, was not evenly distributed. At the height of the crisis, which was the five-year

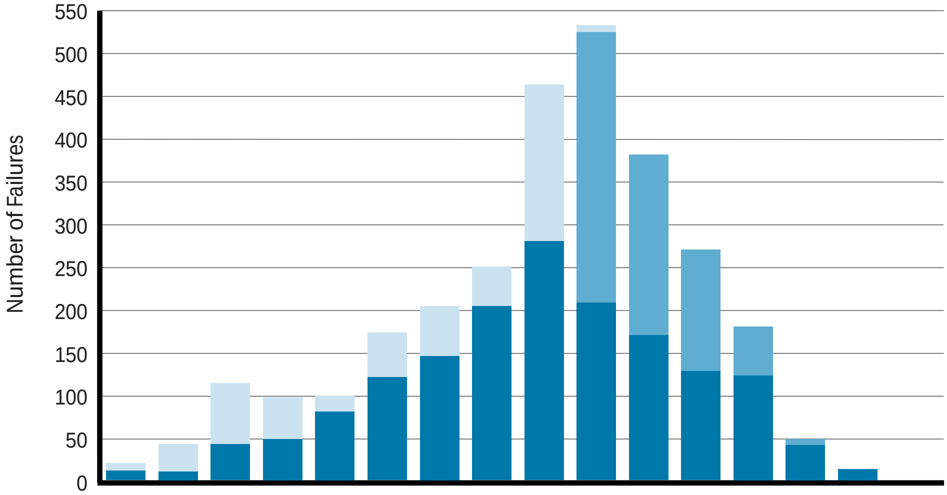
2. Federal Deposit Insurance Corporation, *The First Fifty Years: A History of the FDIC, 1933-1983* (Washington, D.C.: FDIC, 1984), 36.

3. Federal Home Loan Bank Board 1988 reports.

4. The RTC did not provide open bank assistance.

Chart I.1-1

Combined Number of Failures (Banks and Savings & Loans) 1980–1994



	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	Totals
FSLIC Failures	11	34	73	51	26	54	60	48	185	8						550
RTC Failures										318	213	144	59	9	2	745
FDIC Failures	11	10	42	48	80	120	145	203	279	207	169	127	122	41	13	1,617
Total	22	44	115	99	106	174	205	251	464	533	382	271	181	50	15	2,912

Figures include open bank assistance transactions.

Sources: Reports from FDIC Division of Research and Statistics.

period between 1988 and 1992, a bank or savings and loan failed on an average of once a day, bringing with it a daily influx of $385 million in assets. (See chart I.1-1.)

Another perspective on the crisis is that over the 15-year period, about one out of six federally insured depository institutions were either closed or needed financial assistance. Those institutions held 20.5 percent of the assets in the banking system.[5]

Role of the FDIC and the RTC

As an independent deposit insurance agency for member banks and savings associations, the FDIC has three primary responsibilities: to act as an insurer, a receiver, and a super-

5. The "6:1" ratio was calculated by taking the number of open federally insured banks and savings and loan associations at the end of 1987 (the mid-point of the crisis period) and dividing by the number of institutions that failed or received assistance over the entire 15-year period from 1980-1994 (17,325/2,912).

visor.[6] Two of these roles—those of insurer and receiver—require that the FDIC play an active role in resolving failing and failed FDIC insured institutions. Those roles are the subject of this study. The interaction between the FDIC as insurer and the FDIC as receiver is important in promoting the efficient, expeditious, and orderly liquidation of failed banks and thrifts to maintain confidence and stability in the U.S. banking system.

First and foremost, the FDIC was established to insure bank deposits. This role of insurer helps ensure the stability of the financial system by guaranteeing the timely funding of insured deposits and the consequent faith in the U.S. banking system in times of stress. The FDIC fulfills this role when a bank fails by paying insured depositors either by direct payment or arranging for the assumption of the deposits by another financial institution. The importance of this role was critical in the bank and thrift crisis of the 1980s and early 1990s. Despite the huge number of bank and thrift failures during this period, there was no evidence of serious runs or credit flow disruptions at federally insured institutions. Most importantly, no depositors suffered any loss of their insured deposits.

When a depository institution fails, the FDIC is normally appointed receiver of the institution by the courts or other authority having jurisdiction. The FDIC's role as receiver is important because it holds the responsibility to the creditors of the receivership to efficiently recover for them the maximum amount possible on their claims. The FDIC itself also becomes a creditor of the receivership. By paying the insured depositors or by arranging their assumption by another institution, the FDIC steps into the shoes of the depositors as a creditor (the FDIC is the subrogee). By returning a significant portion of the failed institution's assets to the private sector quickly, the FDIC as receiver helps replenish the insurance fund while contributing to the stabilization of weakened local economies. When acting as receiver, the FDIC has broad statutory authority and expansive powers to ensure the efficiency of the receivership process. These powers allow the FDIC to expedite the liquidation process for failed institutions and maximize the cost-effectiveness of the receivership process.

Although not a part of the FDIC's primary role, Congress passed various initiatives to further national policy goals. To this end, for example, the FDIC has operated an Affordable Housing Program (AHP) that provides assistance in the form of credits or grants to low-and moderate-income households that purchased lower-valued housing owned by the FDIC as receiver. In addition, the FDIC operated a program during the crisis period to promote the use of minority- and women-owned businesses for various contracted services.

The RTC existed from August 1989 through December 1995 and was established by Congress as a temporary federal agency to clean up the savings and loan (S&L) crisis after the FSLIC fund became insolvent. The RTC's two main roles were to act as conservator and receiver of the insolvent thrifts.[7] It had a third role, also required by law, to

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6. Detailed information about the FDIC's supervisory role during the 1980s and early 1990s can be found in the FDIC's *History of the Eighties—Lessons for the Future: An Examination of the Banking Crisis of the 1980s and Early 1990s.*

7. A conservatorship is established when a regulatory authority appoints a manager, such as the RTC, to take control of a failing institution to preserve assets and protect depositors.

preserve affordable housing held by the receiverships and to facilitate sales to qualified individuals and organizations.

In its role as conservator, the RTC took control of the operations of hundreds of insolvent S&Ls. These institutions remained open, but their operation and their employees came under control of the RTC until the best method for resolution could be determined and implemented. The objectives of the conservatorship were to establish control and oversight while promoting consumer confidence; to evaluate the condition of the institution and determine the most cost-effective method of resolution; and to operate the institution in a safe and sound manner pending resolution by minimizing operating losses, limiting growth, eliminating any speculative activities, and terminating any waste, fraud, and insider abuse. Shrinking an institution by curtailing new lending activity and selling assets also was a high priority. Although a conservatorship is a temporary solution to gain control of a failing institution and to reduce resolution costs, many S&Ls were in conservatorship for long periods of time because the number of insolvent thrifts was large, staff resources were limited, and funding was periodically interrupted.

The RTC's role as receiver is very similar to that of the FDIC's, as described above. It held the same type of special powers, such as the ability to repudiate burdensome contracts and eliminate certain contingent liabilities. A pass-through receivership was usually established at the time that the RTC became conservator or sometime during the conservatorship.[8] When the conservatorship was finally resolved, the institution was then placed into a (second) receivership.

The RTC also was under a statutory obligation to ensure the preservation and disposition of available affordable housing. Thrifts in the United States are a primary provider of mortgages for single and multi-family housing. The drafters of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 recognized that an unprecedented amount of affordable housing would come into the hands of the RTC and could be made available for very low-, low-, and moderate-income families. In response to that, the RTC established a national program to meet the objectives of the legislation.

Major Objectives of the FDIC and the RTC

In its unique roles as deposit insurer of banks and savings associations and also as receiver of failed institutions, the FDIC seeks to maintain stability and the public confidence in the nation's banking system. In the event of institution failures, the FDIC maintains

8. A pass-through receivership is when all deposits, substantially all assets, and certain nondeposit liabilities of the original institution instantly "passed through the receiver" to a newly chartered federal mutual association, subsequently known as the "conservatorship."

stability and public confidence in the system by providing the public with ready access to their insured funds. The FDIC helps ensure the stability of the financial system in times of stress by providing timely or quick resolution of failed institutions. This stability helps promote public confidence in the system and restores liquidity to the economy.

To further minimize disruption to the public during the resolution of failed institutions, the FDIC tries to dispose of the remaining assets of a failed institution as soon as practicable. This allows for quicker payments to the remaining creditors of the failed institution.

As a federal agency with a statutorily limited life, the RTC had a narrower focus than the FDIC. FIRREA gave the RTC the responsibility of managing and resolving all failed depository institutions previously insured by the FSLIC and for which a conservator or receiver was appointed from January 1, 1989, through August 8, 1992. (This was later extended to June 30, 1995.) The main objectives of the RTC defined by FIRREA were (1) to maximize the net present value return from the disposition of failed thrifts and their assets, (2) to minimize the effect of such transactions on local real estate and financial markets, and (3) to maximize the availability and affordability of residential real property for low- and moderate-income individuals.

Each of the three RTC objectives was, in some important way, at odds with the other two. The goal of maximizing the return for the receiverships often meant selling the assets as quickly as possible for the highest price. The goal of minimizing the effect on local markets, however, would imply a measured, if not conservative, approach to the timing of the sale and careful pricing of the thousands of properties before placing them in their respective markets. Finally, to comply with FIRREA, affordable housing sales had to be closely monitored before and after the sale, and a significant portion of the owned real estate portfolio was reserved for lower income individuals. These requirements increased holding and disposition costs, which to some extent put the RTC at odds with its first two objectives.

Compounding the challenge was the fact that from its creation in August 1989, the RTC was responsible for an unprecedented workload. By December 31, 1990, the end of its first full year of operation, the RTC had been appointed conservator of 531 thrifts that contained $278.3 billion in assets. In contrast to the FDIC, which could rely on insurance premiums paid by banks, the RTC had no internal source of funds. It relied on congressional appropriations and other indirect sources to fund its operations. Also, because appropriations to pay for insolvent thrifts were not popular, the RTC was hampered by delays in obtaining funding. Funding came in stages and each stage required separate legislation and congressional approval. The legislative involvement made long-term planning of the resolution process difficult.

To meet its first two objectives of maximizing the return on the failed thrift assets and minimizing any economic disruption to affected communities, the RTC engaged in the conservatorship process, and drew on the experiences of the FDIC for dealing with the disposition of numerous receiverships with a large volume of assets. The RTC was given conservatorship powers in FIRREA as a means to get the failed and failing thrifts under government control for as little cost as possible. As conservator, the RTC could begin reducing the expenses of the thrift, curtail new lending to lessen demands on liquidity, and sell assets to raise the working capital necessary to keep the thrift open until government funds were available to fully resolve the thrift.

The RTC reduced expenses by engaging in a strategy early on of not renewing conservatorship depositors' interest-bearing deposits above the current market rates, thus eliminating much of the high cost of funds. As conservator, the RTC could openly market the assets and the franchise because the troubled status of the thrifts under conservatorship was public knowledge. The FDIC, on the other hand, was more secretive in its bank pre-failure marketing efforts because it was dealing with an ongoing franchise that might not fail and too much negative publicity could cause a run on deposits, thereby bringing about the closing of the bank unnecessarily.

Because of the delays in funding, which forced institutions to stay in conservatorship for extended periods of time, the RTC's asset disposition strategy also became very different from the FDIC's. The FDIC emphasized the sale of the maximum amount of the failed bank's assets to the bank acquirer at resolution. The RTC, on the other hand, focused on selling the assets directly from the conservatorship or receivership, and only a limited amount of assets were passed to the acquirer at resolution.

Because of the size of the S&L problem, one of the RTC's earliest challenges was dealing with the requirement of selling assets quickly without being accused of "dumping" them for perceived too low prices. The language in FIRREA concerning this issue led to lagging sales and burgeoning inventories. By 1991, the language of FIRREA was amended to allow the RTC to sell properties more quickly.[9]

As mandated in FIRREA, the RTC also began contracting with private asset management and disposition firms to dispose of the assets. Because of its limited life, the RTC did not have the time or resources to develop the necessary experienced staff. The RTC expanded on the FDIC's methods of using large private firms and developed a number of innovative techniques to meet its objectives. The RTC also developed national sales centers to sell assets in bulk and partnerships with private asset management firms. In the area of securitization, the RTC created markets for securitizing less traditional assets, such as commercial loans. These securitization efforts made it possible for the RTC to dispose of a large volume of thrift assets under difficult time constraints and at prices that might not have been realized in whole loan sales markets.

The RTC was not faced with the same set of resolution circumstances as the FDIC. Because of the RTC's funding limitations and its having so many thrifts in conservatorship, the RTC had to set priorities in its resolution schedule. It selected those institutions that presented the best opportunity for minimizing costs to the RTC or those with

9. FIRREA included language requiring the RTC to sell real estate for no less than 95 percent of its appraised (market) value. In 1991, in response to growing criticism about low sales and congressional concern with the cost of maintaining the rapidly growing inventory of properties, FIRREA was amended to reduce the minimum sales price to no less than 70 percent of appraised value.

a higher rate of deterioration because of operating losses, eroding core deposit bases, and loss of key personnel.

The RTC was innovative in separating the sale of assets from the sale of liabilities in its franchise marketing efforts, and it developed new methods that allowed it to sell a large number of institutions in a short time. The RTC's focus on branch breakup transactions increased bidder participation, competition, and flexibility in the resolution process and ultimately led to increased premiums.

To meet the objective of fulfilling the affordable housing mandate, the RTC developed a formal program for this area. In the process, the RTC established working relationships and partnerships with many public and private entities across the country to achieve their goals. By its sunset date of December 31, 1995, the RTC had sold over 100,000 units of affordable housing.

Legislative Framework

Until the 1980s, most of the FDIC's resolution powers were generated from legislation enacted in the 1930s and 1950s. As the banking and thrift crisis deepened the FDIC and the RTC needed expanded and improved powers to meet their resolution objectives. Congress focused on these banking problems throughout the 1980s and 1990s by enacting legislation that provided new resolution tools, re-capitalized the depleted insurance funds, and promoted stronger supervision and less regulatory discretion.

One of the first significant pieces of banking legislation passed in response to the banking and thrift problems in the late 1970s was the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980. With a goal of improving the competitiveness of banks and thrifts, DIDMCA began the process of deregulating the interest rate ceilings that could be offered to depositors and raised the deposit insurance limit from $40,000 to $100,000.

The next major banking legislation of the 1980s occurred when Congress passed the Garn–St Germain Depository Institutions Act (Garn–St Germain) of 1982. This act was aimed at resolving problems in the S&L and savings bank industries by further expanding their powers, allowing them to compete in the area of commercial lending. It also provided them with direct investment authority. The deregulation of restrictions on interest rates and their subsequent increase led to some well-managed institutions becoming significantly undercapitalized. To temporarily augment the capital of these select institutions, a type of regulatory forbearance was included in the act in the form of net worth certificates (NWC). In addition, Garn–St Germain broadened the FDIC's ability to use OBA, which occurs when a distressed financial institution remains open with government financial assistance. The FDIC no longer had to prove that an institution was essential to the community for it to be allowed to receive OBA. The FDIC could use OBA if its use was less costly than the estimated cost of liquidating the subject institution.

Both bankers and regulators were not prepared for the affects that deregulation would have on the banking industry. This led to a series of banking legislation enacted in the 1980s and 1990s to attempt to mitigate and control the crisis that followed.[10]

As the thrift crisis worsened and commercial bank failures increased, Congress passed the Competitive Equality Banking Act (CEBA) of 1987. This act contained several provisions that were particularly significant for the FDIC. It expanded the FDIC's emergency interstate acquisition authority and permitted the FDIC to establish a temporary bridge bank.[11] (A bridge bank is a chartered national bank that operates under a board appointed by the FDIC; it assumes the deposits and certain other liabilities and purchases certain assets of one or more failed banks.) CEBA also authorized a forbearance program for agricultural banks that allowed them to amortize their losses on agricultural loans over seven years, rather than deduct the amount of loss from capital as soon as the loss was identified.

Because of the extent of the thrift crisis, the FSLIC reserves were exhausted and its insurance fund became insolvent. Congress passed FIRREA in 1989, at a time when the FSLIC was confronted with some 600 seriously troubled savings associations with assets of about $350 billion. FIRREA dissolved the FSLIC, authorized use of taxpayer funds to resolve failed thrifts, and established the RTC. The RTC was mandated to merge or liquidate savings associations previously insured by the FSLIC that would be declared insolvent during the period from January 1, 1989, through August 8, 1992 (later extended to June 30, 1995), with the FDIC named as the manager of the RTC.

FIRREA also significantly changed the financial institution regulatory structure and strengthened the authority of federal supervisors to require adequate capital, promote safe banking practices, and ensure compliance with applicable laws. The powers and duties of the FDIC in particular were greatly expanded. Some of the key provisions of FIRREA included: eliminating the existing thrift regulatory structure and creating the Office of Thrift Supervision (OTS) in its place, moving the responsibility of thrift deposit insurance to the FDIC, authorizing the FDIC to assess insured depository institutions whose affiliated insured depository institutions had failed (that is, cross guaranty assessment authority), and authorizing the FDIC and the RTC to appoint themselves as sole conservator or receiver of any insured state depository institution, provided certain criteria were met.

The next act that had a significant impact on the FDIC was the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991. While the law touched a wide range of regulatory areas, certain provisions—particularly those pertaining to

10. For more information see Appendix A, Legislation Governing the FDIC's Roles as Insurer and Receiver.

11. CEBA extended and expanded the FDIC's emergency interstate acquisition authority so that when the FDIC was resolving institutions with assets greater than $500 million, bank holding companies could be sold in whole or in part and out-of-state holding companies would be permitted expansion rights in the state of acquisition. This authority came at a critical time as the size of institution failures was increasing and fewer intrastate acquirers of sufficient size and strength were available.

prompt corrective action (PCA) for failing institutions and to least cost resolutions—had profound effects on the way the FDIC conducted failed bank resolutions. Federal regulators were required by FDICIA to establish five capital levels, ranging from well-capitalized to critically undercapitalized, that serve as the basis for PCA. As an institution's capital declines, the appropriate regulator must take increasingly stringent measures. One of the aspects of PCA that most directly affects the FDIC's approach to resolutions prescribes mandatory measures for critically undercapitalized institutions, which are banks with tangible equity equal to or less than 2 percent of total assets. Provisions of FDICIA also require that a conservator or receiver must be appointed no later than 90 days after an institution falls into the critically undercapitalized category. The appropriate federal regulatory authority can grant up to two 90-day extensions of the PCA period if it determines that those extensions would better protect the relevant insurance fund from long-term losses.

FDICIA also requires that if the FDIC does not liquidate a failing institution (conduct a deposit payoff), then it must pick the least costly resolution alternative. All bids must be considered together and evaluated on the basis of comparative cost; other policy considerations, regarding which regulators previously had some discretion, cannot be factored into the determination of the appropriate transaction. FDICIA compelled the FDIC to consider more transaction options than in the past to make certain that all feasible least cost structures were offered.

Revisions to the FDIC's OBA authority were the subject of two separate FDICIA provisions. First, the FDIC could provide OBA only if it had determined that grounds for the appointment of a conservator or receiver exist and that the institution's capital is not likely to be increased without assistance. Second, the FDIC had to determine that the institution's management was competent and not the cause of its problems.

As the banking and thrift crisis peaked in the early 1990s, the RTC Refinancing, Restructuring, and Improvement Act (RTCRRIA) of 1991 was passed and further segregated the RTC from the FDIC. The restructured RTC was to be headed by a chief executive officer appointed by the president with the advice and consent of the Senate, instead of the FDIC chairman and Board of Directors. The RTC Oversight Board was recast into the Thrift Depositor Protection Oversight Board, made up of five government officials and two private sector representatives. RTCRRIA provided the RTC with $25 billion more in funding through April 1, 1992, and extended the RTC's ability to accept appointment as conservator or receiver from August 9, 1992, to September 30, 1993.

Of particular importance to the deposit insurance funds was a major provision in the Omnibus Budget Reconciliation Act of 1993. The act included a national depositor preference provision, which pertained to all insured depository institutions that closed on or after August 10, 1993. This provision stipulates that a failed institution's depositors (including the FDIC standing in the place of insured depositors it has already paid) have priority over general creditor claims. It was established to standardize the claims process and to reduce the FDIC's and the RTC's cost of resolutions. Previously, asset proceeds were distributed according to the law of the jurisdiction that chartered the failed institution.

In terms of the mission of the RTC and the FDIC, after FIRREA, the most significant banking statute was the RTC Completion Act (Completion Act) of 1993. From April 1, 1992, through December 17, 1993, the RTC did not have sufficient funding to resolve additional failed savings and loan institutions. The Completion Act removed the April 1, 1992, deadline for the use of funds that had previously been established, thus permitting the RTC to use the remaining $18.3 billion authorized under RTCRRIA to resolve the remaining insolvent thrifts. The act also extended the September 30, 1993, deadline for appointment of the RTC as conservator or receiver for savings associations to a date between January 1, 1995, and July 1, 1995, to be determined by the chairperson of the Thrift Depositor Protection Oversight Board. The transfer of the RTC operations to the FDIC and termination of the RTC was accelerated from December 31, 1996, to December 31, 1995. The RTC was required to adopt a series of management reforms and implement provisions designed to improve the agency's record in providing business opportunities to minorities and women when issuing RTC contracts or selling assets. The AHP was amended to add the requirement that the FDIC and the RTC provide tenants a right of first refusal to purchase one-to-four family residences owned by the FDIC or the RTC. The changes also required the agencies to give limited preference to offers from nonprofit corporations, government agencies, and others that would provide for use of a property by homeless individuals and families.

Methods of Handling Bank and S&L Failures

The FDIC and the RTC used different approaches to find the most efficient way of managing bank and thrift failures. The resolution process itself went through a series of changes and adjustments throughout the crisis period because of ever-changing market conditions and legislation that prompted innovative cooperation between the government and the private sector. Until the early 1980s, the FDIC most often relied on the purchase and assumption (P&A) resolution process in which an acquirer purchased some or all of the assets and assumed certain liabilities. If an acquirer could not be found, the FDIC used a deposit payoff resolution where the depositors were paid an amount equal to their insured funds and all other liabilities and assets were held by the FDIC as receiver. These resolution options were later expanded to include ones that allowed for financial assistance to weakened, open institutions (open bank assistance) and maximized opportunities to get failed institutions' assets into private hands as efficiently and quickly as possible.

The types and sizes of the assets and liabilities of the failed banks influenced the resolution methods that were created and used. In the 1970s and the early 1980s, there had been few closings and the FDIC was more concerned about the safety and soundness of the newly created bank than whether the assets of the failed bank passed to the acquirer.

The acquiring bank generally purchased only the cash and cash equivalents of the bank, which left all the other assets for the FDIC to resolve. The resolution process changed as bank failures grew in the mid-1980s and traditional resolution methods proved inadequate. The FDIC determined that a strategy of passing as many of the assets as possible at resolution to acquirers would reduce the strain on the liquidity of the insurance fund and on its limited staffing resources while moving the assets more quickly back to the private sector.

The resolutions used by the RTC were similar to those used by the FDIC. The RTC also used P&A transactions and deposit payoffs, although it did not have the authority to engage in OBA. The RTC's methods of handling institution failures, however, were different from the FDIC's primarily due to the situation that the RTC had inherited. When the RTC was established in August 1989, it immediately assumed responsibility for 262 thrift institutions in conservatorship with assets of $115 billion. Because of sporadic funding, the RTC often had to delay its resolution plans.

As a result of provisions in a series of legislation, beginning with FIRREA, the RTC also developed resolution programs to preserve and, if possible, to increase the number of minority-owned institutions. The programs were structured to give preference to potential acquirers of the same ethnic identification as the previous owners' if the bids were less costly than a payoff would be. The programs were expanded in 1993 to give bidding preference to a minority acquirer making an offer for any thrift or any of its branches, located in a neighborhood where 50 percent of the residents were minorities. The number of minority-owned thrifts that failed was relatively small. Of those that did fail, however, minority ownership was preserved in approximately 50 percent of those that were purchased.

The RTC resolution process evolved into a simpler process than the FDIC's. Because the public was already aware that the RTC had control of an institution, there was no need for the secrecy that was required when the FDIC took bids on open institutions. The RTC was able to widely market the thrifts by placing advertisements in national publications. It developed ways to market and sell large numbers of thrifts in a short time. It simplified its process by making a conscious decision to separate the marketing of the assets from the marketing of the deposit franchise. The RTC completed resolutions on 747 thrifts.

The three primary methods of resolutions, the P&A transaction, the deposit payoff, and the OBA option, are described in more detail below.

Purchase and Assumption Transactions

A P&A is a resolution transaction where a healthy insured institution purchases some or all of the assets and assumes, at a minimum, all insured deposits and may assume all of the deposit liabilities of a failed bank or thrift. The P&A was the favored resolution policy of the FDIC. From 1980 to 1994, the FDIC handled 1,188 of the 1,617 failing and failed institutions, or 73.5 percent, through P&A transactions. Similarly, of the $302.6

billion in assets and $233.2 billion in deposits, $204 billion of the assets (67.4 percent) and $161.3 billion of the deposits (69.2 percent) were in the 1,188 institutions handled through P&A transactions.

Like the FDIC, the RTC's emphasis during its resolution history generally was on P&A transactions. Of the 747 institutions resolved by the RTC, 497 institutions, or 66.5 percent, were handled through P&As. Similarly, of the $220.6 billion in deposits at those 747 institutions, $161 billion of the deposits, or 73 percent, were in the 497 institutions handled through P&A transactions.

As the number of failures increased and resources were stressed, the P&A transaction evolved. In early P&As, the acquiring bank generally assumed all of the failed bank's deposit liabilities (including uninsured funds) and certain secured liabilities. The acquirer also purchased a limited amount of "clean" assets (like cash and cash equivalents). The FDIC generally did not sell loans to an acquiring institution, thereby retaining the assets' associated risk.

When the amount of assets it received began to overwhelm the FDIC, it tried to transfer as many assets as possible to the acquiring banks by using a "put" option. To induce the acquirer to take more assets, the FDIC required the acquirer to take assets, but allowed them to put back to the FDIC those assets they did not wish to keep within a specified timeframe. While the put option was a way to pass more assets to the acquirer, thereby lowering the initial cash payment to the acquiring bank, there were several significant problems with this feature. First, acquirers were able to "cherry pick" the assets, choosing to keep only those with market values above book value or assets having little risk, while returning all other assets. Second, assets tended to be neglected by the acquirer during the put period before being returned, which adversely affected their value. Finally, the limited due diligence before bidding did not allow acquirers to include the potential profits in their bids. The FDIC discontinued use of the put option as a resolution tool in late 1991. The RTC also used put options in an attempt to pass more assets. Put options were used extensively during the first year of the RTC's existence and their results were similar to those experienced by the FDIC. Although approximately $40 billion of assets were sold subject to put options, over $20 billion of those assets were subsequently returned to the RTC.

Another method used by the FDIC to induce acquirers to retain assets was to give priority to bidders that proposed taking the largest number of assets at resolution. That policy led to the use of the whole bank P&A transaction. This type of transaction passed to the acquirer virtually all of a failed bank's assets and deposits. The FDIC made a one-time payment to the winning bidder and in return the acquirer assumed all of the risk associated with ownership of the assets and liabilities of the institution.

Whole bank sales were widely used from 1988 to 1991 and during that period represented 23 percent of the FDIC's total resolution transactions. At that time (pre-FDICIA), whole bank bids simply had to be less expensive to the FDIC than the cost of liquidation; after the least cost provisions were mandated, though, whole bank bids could no longer remain competitive. While the FDIC maximized its transfer of assets back to the private sector and most significantly preserved liquidity, this strategy likely came at the expense of somewhat higher overall resolution costs.

By the early 1990s, the FDIC was having difficulty obtaining reasonable bids from acquirers for portfolios of commercial loans from large bank failures. To convince reluctant acquirers to purchase these loans, the FDIC developed P&As with a loss sharing feature. In those transactions, the FDIC reduced the acquirer's risk by covering the majority of the loss (and receiving the majority of the recovery) on certain pools of problem assets, and the acquirer agreed to take responsibility for the remainder of the loss on those asset pools. Between 1991 and 1993, the FDIC implemented loss sharing a total of 16 times, primarily at large bank failures, to resolve 24 failed banks. (See table I.1-1.)

Loss sharing transactions kept failed bank assets in the banking sector. The loss share transactions were able to pass $18.5 billion, or 45 percent, in failed bank assets under loss sharing and another $17.8 billion, or 43 percent, to the acquirer without loss sharing, which left only $5.1 billion, or 12 percent, of residual assets retained by the FDIC for liquidation. In comparison, the 175 P&A transactions during 1991 and 1992 that did not involve loss sharing accounted for $62.1 billion in failed bank assets and were able to pass just $24.3 billion, or 39 percent, of the failed bank assets to the acquirers.

The P&A transactions with loss sharing were less expensive than those without it, including whole bank transactions. The 24 failed loss share banks were resolved by the FDIC at a cost of $2.5 billion, or 6.1 percent of assets. The 175 banks resolved by P&As without loss sharing during the period were resolved by the FDIC at a cost of $6.5 billion, or 10.4 percent of assets. A further comparison of costs of loss share transactions and conventional P&A transactions has been made on both large banks (total assets over $500 million) and small banks with assets under $500 million. In both small and large banks that failed during the same period, the costs in relation to total assets were less expensive on the loss share transactions.

Under the various P&A asset purchase structures offered post-FDICIA, bidders were given the option of bidding on only the insured deposits. Because an "insured deposit only" bid did not have to compensate the FDIC or the RTC for the additional cost of covering 100 percent of the uninsured depositor's claim, it was easier for an insured deposit only bid to pass the least cost test. Additionally, as the FDIC and the RTC began offering this option on an increasingly regular basis, acquirers discovered that the effects of not covering the uninsured depositors were less detrimental than they had once believed.

The results of this change in acquirer bidding behavior were immediately apparent. Chart I.1-2 displays the number of failed banks where the uninsured depositors were both protected and unprotected from 1986 through 1995. On average, 82 percent of all banks failing from 1992 to 1995 were resolved in a manner that did not provide full protection to uninsured depositors, compared with 17 percent from 1986 to 1991. Perhaps more significantly, 85 percent of all the deposits in banks that failed from 1986 to1991 were in banks where all deposits were protected. By comparison, only 15 percent of the deposits in failed banks from 1992 to 1995 were in banks where all deposits were

Table I.1-1

FDIC Loss Share Transactions 1991–1994

($ in Millions)

Transaction Date	Failed Bank*	Location	Total Assets	Resolution Costs	Resolution Cost as Percentage of Total Assets
09/19/91	Southeast Bank, N.A†	Miami, FL	$10,478	$0	0.00
10/10/91	New Dartmouth Bank	Manchester, NH	2,268	571	25.19
10/10/91	First New Hampshire	Concord, NH	2,109	319	15.14
11/14/91	Connecticut Savings Bank	New Haven, CT	1,047	207	19.77
08/21/92	Attleboro Pawtucket S.B.	Pawtucket, RI	595	32	5.41
10/02/92	First Constitution Bank	New Haven, CT	1,580	127	8.01
10/02/92	The Howard Savings Bank	Livingston, NJ	3,258	87	2.67
12/04/92	Heritage Bank for Savings	Holyoke, MA	1,272	21	1.70
12/11/92	Eastland Savings Bank‡	Woonsocket, RI	545	18	3.30
12/11/92	Meritor Savings Bank	Philadelphia, PA	3,579	0	0.00
02/13/93	First City, Texas-Austin, N.A.	Austin, TX	347	0	0.00
02/13/93	First City, Texas-Dallas	Dallas, TX	1,325	0	0.00
02/13/93	First City, Texas-Houston, N.A.	Houston, TX	3,576	0	0.00
04/23/93	Missouri Bridge Bank, N.A.	Kansas City, MO	1,911	356	18.62
06/04/93	First National Bank of Vermont	Bradford, VT	225	34	14.97
08/12/93	CrossLand Savings, FSB	Brooklyn, NY	7,269	740	10.18
Totals/Average			**$41,384**	**$2,512**	**6.07**

* The banks listed here are the failed banks or the resulting bridge bank from a previous resolution; however, it is the acquirer that enters into the loss sharing transaction with the FDIC.

† Represents loss sharing agreements for two banks: Southeast Bank, N.A., and Southeast Bank of West Florida.

‡ Represents loss sharing agreements for two banks: Eastland Savings Bank and Eastland Bank.

Source: FDIC Division of Research and Statistics.

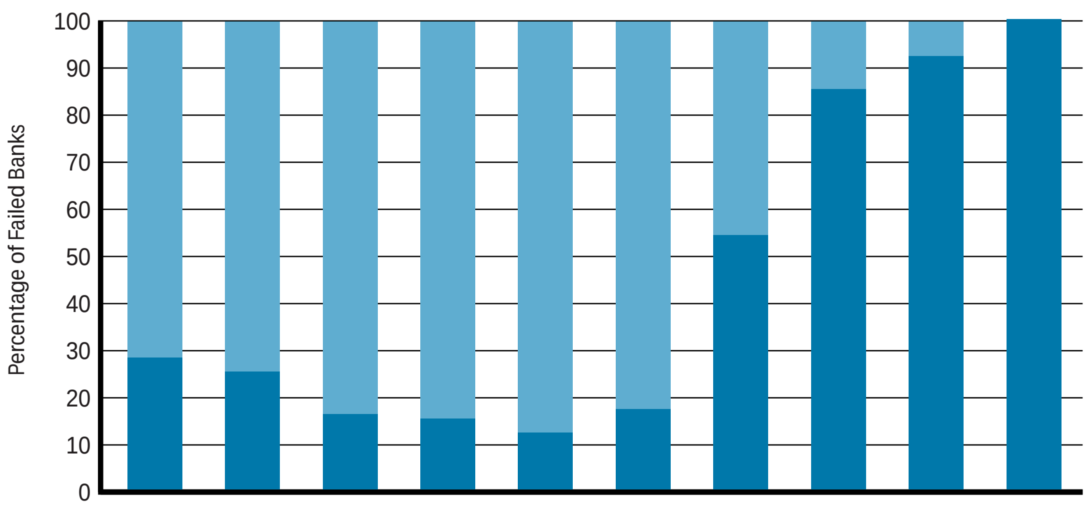
protected. One of the intentions of FDICIA was that uninsured depositors bear more of the cost of bank failures. This result appears to have been achieved. Uninsured depositors did, however, receive some relief as the Omnibus Budget Reconciliation Act of 1993 included a national depositor preference provision giving them priority over general creditors of the receivership.

Deposit Payoffs

Deposit payoffs were used when no acquirer could be found or if the FDIC or the RTC did not receive a less costly bid for a P&A transaction. Generally, deposit payoffs occurred in smaller bank failures when there was little interest in the banking franchise. In a deposit payoff, no liabilities are assumed and no assets are purchased by another institution. The FDIC or the RTC would pay depositors of the failed institution the amount of their insured deposits either directly (known as a straight deposit payoff) or through a healthy institution that acts as the FDIC or the RTC's agent (called an insured deposit transfer, or IDT). Depositors with uninsured funds and other general creditors

Chart I.1-2

Uninsured Depositor Treatment 1986–1995



	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Uninsured Protected (%)	72	75	84	85	88	83	46	15	8	0
Uninsured Not Protected (%)	28	25	16	15	12	17	54	85	92	100

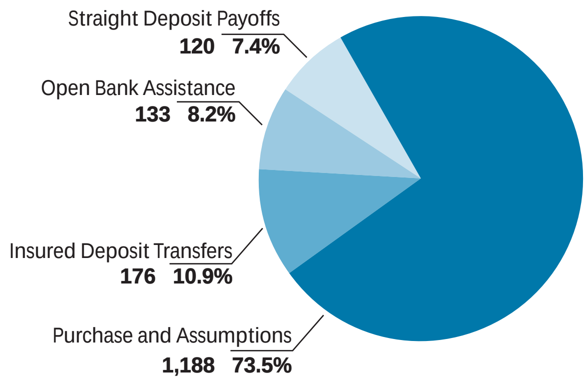
Source: FDIC Division of Finance, *Failed Bank Cost Analysis, 1986–1995.*

of the failed institution were given receivership certificates entitling them to a share of the net proceeds from the sale of the failed institution's assets.[12]

In 1983, the FDIC introduced the insured deposit transfer. An IDT involves the transfer of insured deposits and secured liabilities of the failed bank to a healthy institution that agrees to act as the FDIC's agent. The agent bank makes available to the depositors of the failed bank a "transferred deposit" account. The IDT saved the FDIC considerable overhead expense while providing an opportunity for the agent bank to introduce their services to potential new customers.[13] Because this type of transaction reduced the disruption caused by a deposit payoff to insured depositors and to the local community, it was considered more consumer-friendly than a straight deposit payoff and was employed whenever practicable. At times, however, certain circumstances precluded its use, such as when no other bank was interested in performing the "as agent" role, when perhaps too many deposits were tied to loans, or when the FDIC had to act so quickly that there was no time to set up such a transaction with another bank.

Chart I.1-3

FDIC: Bank Failures by Resolution Method 1980–1994



Total Bank Failures = 1,617

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

Of the 1,617 failing and failed institutions handled by the FDIC between 1980 and 1994, deposit payoffs were used 296 times, or 18.3 percent of the total. These transactions represented only 5.3 percent of the assets and 6.1 percent of the deposits of the banks handled by the FDIC for this period. IDTs accounted for 176 of the 296 deposit payoffs, or 59.5 percent of the total number of transactions. (See chart I.1-3.)

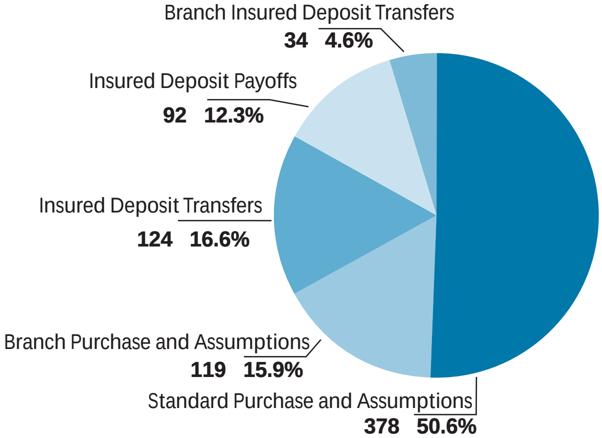
At the RTC, deposit payoffs were more common because many of its early conservatorships consisted of institutions that had been insolvent for some time, were located in declining real estate markets, and had little franchise value because of industry conditions. Of the 747 institutions resolved by the RTC, 158, or 21.2 percent, were handled through IDTs and 92, or 12.3 percent, involved straight deposit payoffs. (See chart I.1-4.)

12. The FDIC's insurance limit is $100,000. Any amount over that limit, including interest, is uninsured. The FDIC uses the term "insured depositor" to refer to any depositors whose total deposits are under the insurance limit. Similarly, the term "uninsured depositor" is used to refer to those depositors whose total deposits are over the insurance limit. It is important to note that customers with uninsured deposits are paid up to the insurance limit, and only that portion of their deposits over the insurance amount is uninsured.

13. FDIC, *1983 Annual Report*, 12.

Chart I.1-4

RTC: Savings and Loan Failures by Resolution Method 1989–1995



Total Savings and Loan Failures = 747

Sources: FDIC Division of Research and Statistics and FDIC annual reports.

In addition, in an effort to alleviate an uninsured depositor's liquidity problems caused by the unexpected loss of their funds, both the FDIC and the RTC issued advance dividends.[14] This type of transaction, originally known as a "modified payoff," allowed the FDIC or the RTC to provide depositors with at least a portion of their uninsured funds more quickly.

Open Bank Assistance

Open bank assistance was a resolution method in which the FDIC provided an insured bank at risk of failure with financial help in the form of loans, contributions, deposits, asset purchases, or the assumption of liabilities. Generally, the majority of a failing institution's assets remained intact.[15] While the term "open bank assistance" gained national recognition with the Continental transaction in 1984, the FDIC had been authorized to provide OBA since 1950.[16] OBA occurred when a distressed financial institution remained open with the aid of the financial assistance from the government.[17] Generally, the FDIC required new management, ensured that the shareholders' interest was diluted to a nominal amount, and called for a private-sector capital infusion. OBA also was used to facilitate the acquisition or merger of a failing bank or thrift by a healthy institution. A major criticism of OBA has been that shareholders of failing institutions have benefited from government assistance, even though historically most of the OBA transactions required the shareholders of the failing institutions to significantly dilute their ownership interests.

The FDIC has not used OBA transactions frequently. From 1950 to 1982, the FDIC could grant OBA only if the institution's continued existence was determined to

14. An advance dividend is a payment made to uninsured depositors immediately or soon after a bank fails, based on the estimated value of the receivership's assets.

15. The RTC was not permitted to use OBA.

16. For further information, see Chapter 5, Open Bank Assistance and Part II, Case Studies of Significant Resolutions, Chapter 4, Continental Illinois National Bank and Trust Company.

17. Several types of assistance to open banks include forms of cash and noncash assistance. To the FDIC, the term "open bank assistance" refers specifically to a resolution method whereby the FDIC gives financial assistance to a troubled bank or thrift to prevent its failure.

be "essential" to providing adequate banking services in the community. The FDIC's authority to provide OBA, however, changed over time. Authority was broadened in the 1980s and then restricted in the 1990s. From 1980 through 1994, the FDIC provided OBA to 133 institutions out of the 1,617 total banks handled by the FDIC, or only about 8.2 percent of the total. OBAs were, however, used for some of the larger failures in the 1980s and represented approximately 27 percent of the assets of the banks handled by the FDIC during this period. Beginning with 1989, the FDIC moved away from providing OBA and entered into only seven OBA transactions from 1989 to 1992. One of the reasons for this was that FDICIA, passed in 1991, required the FDIC to establish that OBA was the least costly resolution option to the insurance fund prior to providing assistance to the failing institution. The FDIC could deviate from the least cost requirement only to avoid systemic risk to the banking system. Finally, under the Completion Act, passed in 1993, insurance funds could not be used to benefit shareholders of the failing institution. There have been no OBA transactions since 1992. (See chart I.1-3.)

Forbearance Programs

Other resolution techniques were developed in the 1980s that were used to stabilize certain regional and economic sector problem situations. The early 1980s were a period of high and volatile interest rates, which particularly affected mutual savings banks (MSB) because those institutions held large portfolios of long-term fixed-rate mortgages. By 1982, MSBs were losing $2 billion annually. In many instances, the market value of the savings banks' assets fell 25 to 30 percent below outstanding liabilities.[18] The FDIC faced the possibility of incurring significant losses for a problem that was believed to be transitory—high interest rates.

Income Maintenance Agreements. One of the FDIC's resolution strategies in the early 1980s was to force weaker savings banks to merge into healthier banks or thrifts by guaranteeing a market rate of return on the acquired assets through an income maintenance agreement. The FDIC paid the acquirer the difference between the yield on acquired earning assets and the average cost of funds for savings banks, thereby assuming the interest rate risk. If interest rates declined to where the cost of funds was below the yield on earning assets, the acquirer was required to pay the FDIC.

Between 1981 and 1983, income maintenance agreements were used to resolve 11 of the assisted mergers of FDIC insured mutual savings banks as detailed on table I.1-2. These banks did not technically fail because they were merged into operating institutions. Depositors and general creditors, therefore, suffered no loss. In most cases, however, the failing bank's senior management was requested to resign, and subordinated note holders only received a partial return of their investment. Because there are no stockholders in a mutual savings bank, the FDIC did not have to concern itself with the

18. FDIC, *The First Fifty Years*, 99.

Table I.1-2

Income Maintenance Agreements

($ in Millions)

Date	Bank Name	Location	Assets	Acquirer	Comments
11/4/81	Greenwich Savings	New York, NY	$2,475	Metropolitan S.B. * (Renamed CrossLand in 1984)	Failed in 1992
12/4/81	Central S.B.	New York, NY	910	Harlem S.B. (Renamed Apple Bank for Savings in 1983)	
12/18/81	Union Dime S.B.	New York, NY	1,453	Buffalo S.B. (Renamed Goldome Bank for Savings in 1984)	Failed in 1991
1/15/82	Western NY S.B.	Buffalo, NY	1,025	Buffalo S.B. (Renamed Goldome)	Failed in 1991
2/20/82	Farmers & Mechanics S.B.	Minneapolis, MN	1,002	Marquette National Bank	
3/11/82	Fidelity Mutual S.B.	Spokane, WA	703	First Interstate National Bank	
3/26/82	New York Bank for Savings	New York, NY	3,404	Buffalo S.B. (Renamed Goldome)	Failed in 1991
4/2/82	Western Savings Fund Society	Philadelphia, PA	2,126	Philadelphia Savings Fund Society (Renamed Meritor S.B.)	Failed in 1992
10/15/82	Mechanics Savings Bank	Elmira, NY	55	Syracuse Savings Bank	Failed in 1987
2/9/83	Dry Dock Savings Bank	New York, NY	2,452	Dollar S.B. (Renamed Dollar Dry Dock Savings Bank)	Failed in 1992
10/1/83	Auburn Savings Bank	Auburn, NY	133	Syracuse Savings Bank	Failed in 1987
Totals	**11 Institutions**		**$15,738**		

* Savings Bank

Sources: FDIC annual reports, 1981 to 1993.

interests of existing stockholders. While the cost savings of the program are difficult to quantify, the income maintenance agreement program provided participating mutual savings banks time to restructure their balance sheets and remain solvent until interest rates became more favorable.

Net Worth Certificates. Another resolution strategy was the Net Worth Certificate (NWC) Program. The program's purpose was to buy time for savings banks to correct rate sensitivity imbalances and restore capital to acceptable levels. Garn–St Germain enabled insured institutions that met statutory requirements to apply for capital assistance in the form of net worth certificates.

Under the program, eligible institutions received promissory notes from the FDIC representing a portion of current period losses in exchange for certificates that were to be considered as part of the institution's capital for reporting and supervisory purposes. Although Garn–St Germain did not prescribe a formula based on specific capital levels, the FDIC established a working formula to purchase certificates equal to between 50 percent and 70 percent of the institution's net operating loss.

The NWC Program allowed solvent, well-managed institutions to survive until the results of restructured balance sheets produced profitable operations or until unassisted mergers with stronger institutions could be arranged. The effectiveness of the NWC Program was largely the result of the drop in interest rates after 1981. In addition, the FDIC was generally able to contain the risks associated with the continued operation of banks having little or no equity. Most of the savings banks were free of serious credit-quality problems, and the relatively small number of savings banks in the program simplified supervision and helped control potentially risky behavior.

Of the 29 savings banks in the plan, 22 required no further assistance and eventually extinguished their net worth certificates. Seven savings banks required additional financial help from the FDIC, four repaid all assistance, and three merged into healthy institutions with additional monetary aid from the FDIC.[19]

Other Forbearance Programs. By the mid-1980s, many regional banks with a concentration of assets, mainly loans in the energy and agricultural sectors, began having serious credit problems and began failing. To save some of these banks, the FDIC developed a resolution strategy of forbearance, which exempted certain distressed institutions that had been operating in a safe and sound manner from capital requirements.

In 1986, the Capital Forbearance Program was established for banks that were weakened as a result of lending to the agricultural and energy sectors. Federal regulators issued a joint policy allowing capital forbearance programs for agricultural banks and banks with a concentration of energy credit. The program was directed at well-managed, economically sound institutions. Eligible banks had to have a capital ratio of at least 4 percent, and their weakened capital position had to be the result of external problems in the

19. FDIC, Office of Research and Statistics, "Open Bank Assistance: A Study of Government Assistance to Troubled Banks from the RFC to the Present" (May 1990), 12.

Table I.1-3

Results of the Capital Forbearance Programs*
Agricultural and Energy Sector Banks

	Regulatory Joint Policy	CEBA Loan Loss Amortization
Number of Banks in Program	301	33
Assets ($ in Billions)	$13.0	$0.5
Avg. Size of Bank ($ in Millions)	$43.2	$15.2
Number of Banks that Survived†	236	29
Number of Banks that Failed	65	4

* Banks that participated in both programs are included only in the regulators' program.
† Banks that left programs as independent institutions or were merged without assistance.
Source: FDIC Division of Research and Statistics.

economy and not mismanagement, excessive operating expenses, or excessive dividends. Ultimately, 301 agricultural and energy sector institutions with assets of approximately $13 billion participated in the Capital Forbearance Program; 236 of these banks survived or merged without FDIC assistance, while 65 of these banks subsequently failed.

Congress's passage of CEBA in 1987 provided the FDIC with another forbearance program aimed at defusing the agriculture crisis. The Agricultural Loan Loss Amortization Program was Congress's initiative to allow "fundamentally sound banks to weather [the current] storm."[20] This program provided additional relief to agricultural lenders by permitting small banks serving predominantly agricultural customers to defer accounting recognition of agriculture-related loan losses. The program allowed those banks to amortize losses over a seven-year period. Only institutions with less than $100 million in total assets with at least 25 percent of their total loans in qualified agricultural credits were eligible for the program. Qualified institutions had to be considered economically viable and fundamentally sound except for needing additional capital to carry the weak agricultural credits.

These temporary forbearance programs were successful; overall, the capital ratio and return on assets of the banks in the programs improved by year-end 1989, a trend that mirrored improving economic conditions in the agricultural and energy markets. Of the 33 banks in this program, 29 survived while 4 failed. (See table I.1-3.)

There are many risks in offering forbearance, but carefully managed programs can prevent institution failures and reduce costs to the insurance fund. Without proper over-

20. *Congressional Record*, 100th Congress, 2d session, March 26, 1987, S.3941.

sight, however, forbearance can create the opportunity for further deterioration and result in increased resolution costs as operating losses accumulate. This is what occurred in the savings and loan industry in the 1980s when forbearance was applied broadly to the whole industry. This did not occur in the bank forbearance programs because a smaller number of institutions were involved and, unlike the FSLIC, the FDIC had the resources to more closely monitor and supervise the participants.

Other Resolution Strategies

The FDIC and the RTC employed other strategies to resolve institutions. Some of those strategies included the use of bridge banks, conservatorships, and branch breakups.

Bridge Banks/Conservatorships. Beginning in 1987 with passage of CEBA, the bridge bank structure became an important part of the FDIC's bank resolution process for large banks with complex financial structures in danger of failing. A bridge bank is a temporary banking structure that is controlled by the FDIC and designed to take over the operations of a failing bank and maintain banking services for the customers. Initially, the FDIC organizes bridge banks for up to two years, with the possibility of up to three one-year extensions. As the name implies, the bridge bank structure is designed to "bridge" the gap between the failure of a bank and the time when the FDIC can implement a satisfactory resolution of the failing bank. The temporary bridge structure provided the FDIC time to take control of a failed bank's business, stabilize the situation, and determine an appropriate permanent resolution. It also enabled the FDIC to gain sufficient flexibility for reorganizing and marketing the bank.

The FDIC used the bridge bank powers sparingly because of its complexity and the fact that smaller banks, which constituted the bulk of the failures, did not require an interim bridge before resolution. Between 1987 and 1994, the FDIC used its bridge bank powers 10 times; most of those instances, however, involved multiple, related bank failures. The 10 situations in which the FDIC used its bridge bank authority resulted in creation of 32 bridge banks into which the FDIC placed 114 individual banks. Those banks had total assets of about $90 billion. During this period, bridge banks made up 10 percent of the total number of bank failures, but they represented 45 percent of the total assets of failed banks. Table I.1-4 summarizes the FDIC's use of its bridge bank authority.

Although the RTC did not have bridge bank authority, FIRREA did empower both the RTC and FDIC with conservatorship authority. Whether a bridge bank or a conservatorship is established, they operate in a similar manner and have the same purpose. Because of the circumstances, however, there are distinct differences in the way that the two agencies used these resolution techniques. On its inception in 1989, the RTC assumed responsibility for 262 failed savings and loan associations already in conservatorship, and resolution loss funding was an immediate problem. Unlike the FDIC's use of bridge banks as a temporary control measure, the RTC was forced to hold many conservatorships open indefinitely. Conservatorships allowed the RTC to take control of a large number of institutions and to begin the process of liquidating their assets until

Table I.1-4

The FDIC's Use of Bridge Bank Authority 1987–1994

($ in Thousands)

Bridge Bank Situations	Failure Date	Bridge Banks	Number of Failed Banks	Total Assets	Total Deposits
1	10/31/87	1 - Capital Bank & Trust Co.	1	$386,302	$303,986
2	07/29/88	2 - First RepublicBanks (Texas)	40	32,835,279	19,528,204
	08/02/88	3 - First RepublicBank (Delaware)	1	*582,350	*164,867
3	03/28/89	4 - MCorp	20	15,748,537	10,578,138
4	07/20/89	5 - Texas American Bancshares	24	*4,733,686	*4,150,130
5	12/15/89	6 - First American Bank & Trust	1	1,669,743	1,718,569
6	01/06/91	7 - Bank of New England, N.A.	1	*14,036,401	*7,737,298
	01/06/91	8 - Connecticut Bank & Trust Co., N.A.	1	*6,976,142	*6,047,915
	01/06/91	9 - Maine National Bank	1	*998,323	*779,566
7	10/30/92	10 - First City, Texas-Alice	1	127,990	119,187
	10/30/92	11 - First City, Texas-Aransas Pass	1	54,406	47,806
	10/30/92	12 - First City, Texas-Austin, N.A.	1	346,981	318,608
	10/30/92	13 - First City, Texas-Beaumont, N.A.	1	531,489	489,891
	10/30/92	14 - First City, Texas-Bryan, N.A.	1	340,398	315,788
	10/30/92	15 - First City, Texas-Corpus Christi	1	474,108	405,792
	10/30/92	16 - First City, Texas-Dallas	1	1,324,843	1,224,135
	10/30/92	17 - First City, Texas-El Paso, N.A.	1	397,859	367,305
	10/30/92	18 - First City, Texas-Graham, N.A.	1	94,446	85,667
	10/30/92	19 - First City, Texas-Houston, N.A.	1	3,575,886	2,240,292
	10/30/92	20 - First City, Texas-Kountze	1	50,706	46,481
	10/30/92	21 - First City, Texas-Lake Jackson	1	102,875	95,416
	10/30/92	22 - First City, Texas-Lufkin, N.A.	1	156,766	146,314
	10/30/92	23 - First City, Texas-Madisonville, N.A.	1	119,821	111,783
	10/30/92	24 - First City, Texas-Midland, N.A.	1	312,987	289,021
	10/30/92	25 - First City, Texas-Orange, N.A.	1	128,799	119,544
	10/30/92	26 - First City, Texas-San Angelo, N.A.	1	138,948	127,802

Table I.1-4

The FDIC's Use of Bridge Bank Authority 1987–1994

($ in Thousands)

Continued

Bridge Bank Situations	Failure Date	Bridge Banks	Number of Failed Banks	Total Assets	Total Deposits
	10/30/92	27 - First City, Texas-San Antonio, N.A.	1	$262,538	$244,960
	10/30/92	28 - First City, Texas-Sour Lake	1	54,145	49,701
	10/30/92	29 - First City, Texas-Tyler, N.A.	1	254,063	225,916
8	11/13/92	30 - Missouri Bridge Bank, N.A.	2	2,829,368	2,715,939
9	01/29/93	31 - The First National Bank of Vermont	1	224,689	247,662
10	07/07/94	32 - Meriden Trust & Safe Deposit Co.	1	6,565	0
10	**Totals**	**32**	**114**	**$89,877,439**	**$61,043,683**

Data for Total Assets and Total Deposits are as of resolution.
Data marked with an asterisk (*) are from the quarter before resolution.
Source: FDIC Division of Research and Statistics.

appropriated funds to finally resolve them became available. The conservatorship function gave the RTC additional time to lower the thrift's high cost of funds and stabilize it while reducing the amount of assets.

The RTC also used conservatorships to a much greater extent than the FDIC used the bridge bank option. From its inception to June 30, 1995, the RTC managed a total of 706 institutions through the conservatorship program, with the number of conservatorships peaking at 353 in 1990. By the end of June 1995, the RTC had resolved all 706 institutions in the program. The FDIC operated only one conservatorship.

The bridge bank and conservatorship resolution methods provided the FDIC and the RTC broad powers to operate and manage large, complex failing financial institutions. Both are temporary measures designed to facilitate organization and stability. The management goal of the newly organized institution was to preserve any existing franchise value of the failing institution, reduce the ultimate cost to the insurance funds, and lessen any disruption to the local community.

Branch Breakups. In certain large failing institutions, there were few, if any, acquirers willing to assume the deposits of a multi-branch bank or thrift. This became a major concern to the RTC in the early 1990s as the size of many of the conservatorships and the general health of the banking and thrift industries limited the amount of competition during the resolution process. In response, the RTC initiated the branch breakup transaction to enhance the franchise value by increasing bidder participation, competition, and flexibility for the resolution process. The FDIC also used the strategy of selling portions of a failed institution to more than one buyer.

Branch breakup transactions became a successful modification to resolution procedures. Of the 747 resolutions handled by the RTC, 153 of those, or 21 percent, involved branch breakup transactions that resulted in more bidders and higher premiums paid to the RTC.

Charts I.1-3 and I.1-4 (presented earlier in this chapter) illustrate the distribution of the resolution methods employed by the FDIC and the RTC during the crisis period.

Methods for Handling Assets

As the number and size of bank failures increased in the early 1980s, the FDIC had to develop more efficient ways of liquidating failed bank assets. The FDIC historically had utilized its internal staff to resolve the assets on an individual basis. In the early and mid-1980s, although the FDIC continued to maintain a core group of employees to work assets, it began a gradual shift to asset marketing and the utilization of private sector contractors as leverage against the increasing volume of assets from failed institutions.

Unlike the FDIC that saw a more gradual build up of failures to resolve, the RTC was charged with the disposition of hundreds of failed institutions and billions of dollars of assets from its inception in 1989. The RTC placed less emphasis on passing assets at resolution than the FDIC did. It focused instead on selling the more marketable failed thrift assets during conservatorship and retaining the more problematic assets for disposition during receivership.

Throughout the crisis, both agencies employed methods of asset disposition such as regional and national auctions, sealed bid, and bulk sales on a large scale. But, as the size, complexity, and volume of the portfolios grew, each agency had to expand their methodologies and experiment with new techniques. For example, the offering of representations and warranties and seller financing eased bidder concerns about buying large, complex pools of loans and real estate.

The FDIC and the RTC developed national satellite auctions, contracted with national firms to manage and market complex real estate assets, and created an effective securitization program. By the 1990s, the FDIC and the RTC had developed their early disposition methods into highly sophisticated procedures and strategies. As a result of those efforts, by the end of 1997 the FDIC held less than $5 billion of the total $705 billion in assets from FDIC and RTC managed bank and thrift failures.

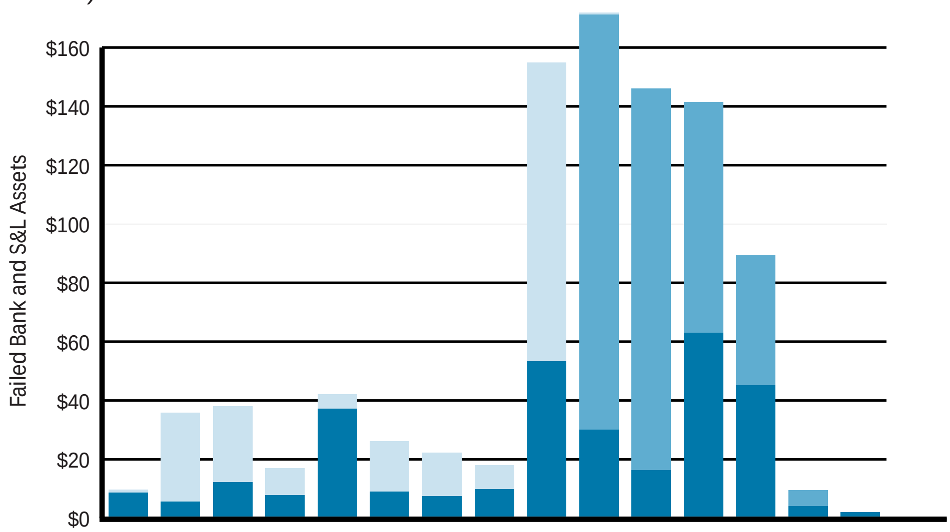
Volume of Assets

From 1980 through 1994, the FDIC resolved 1,617 failed or failing banks that had $302.6 billion in assets. About $230.6 billion, or 76 percent, of those assets were sold to

Chart I.1-5

Failed Bank and S&L Assets 1980–1994

($ in Billions)



	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	Totals
FSLIC*	1.69	30.85	26.44	9.78	5.57	17.73	15.38	8.72	102.14	0.73						219.03
RTC**										141.75	130.25	79.03	44.88	6.11	0.13	402.15
FDIC***	8.08	4.97	11.55	7.27	36.53	8.40	6.82	9.24	52.68	29.40	15.73	62.47	44.55	3.53	1.41	302.63
Total	9.77	35.82	37.99	17.05	42.10	26.13	22.20	17.96	154.82	171.88	145.98	141.50	89.43	9.64	1.54	923.81

* FSLIC assets as reported at resolution.
** RTC assets as reported at time of conservatorship/takeover.
*** FDIC assets as reported at resolution.
Figures include open bank assistance transactions.

Sources: FDIC Division of Research and Statistics, FDIC annual report, RTC Statistical Abstract, and FSLIC annual reports.

the acquiring bank at resolution. From 1989 to 1994, the RTC took over 745 thrifts with total assets of $402.1 billion. In 1995, the RTC's last year, the RTC took over another two thrifts with $426 million in assets. Of the total $402.6 billion in assets, $157.7 billion or 39 percent were collected or sold during conservatorship, $75.3 billion or 19 percent were sold to the acquirer at resolution, and $169.6 billion or 42 percent were retained for disposition during receivership.

From 1980 to 1989, the FSLIC had also acquired a significant volume of assets when it resolved 550 thrifts with total assets of $219 billion. When the FSLIC was dissolved by FIRREA in August 1989, $11 billion in thrift receivership assets were transferred to the FDIC. Altogether, from 1980 to 1994 these three agencies resolved 2,912 banks and thrifts with assets of approximately $924 billion. (See chart I.1-5).

Of the approximately $705 billion in total assets handled by the FDIC and the RTC, about $305 billion were sold through the resolution process. The remaining $400 billion in assets was disposed of through a variety of methods including, but not limited to, auctions and sealed bids, securitizations, equity partnerships, the use of asset management contractors, and especially through the significant efforts of the FDIC and RTC in-house staff.

Auctions and Sealed Bids

Record high interest rates in the late 1970s and early 1980s caused a rapid deterioration in the value of the FDIC's receivership mortgage portfolios. The rise in failing bank activity from the 1980s through the early 1990s caused a corresponding increase in the FDIC's receivership asset holdings. Traditional FDIC asset disposition methods of single asset sales could not keep pace with the volume of assets being received, and by 1976, the FDIC began packaging and selling assets on a limited basis. As the financial crisis developed, the FDIC and the RTC relied heavily on auctions and sealed bids to move large numbers of assets into the private sector.[21]

Loan Sales. In 1984, the FDIC initiated a formal loan sales program to accelerate the disposition of assets acquired from failed banks. The FDIC's asset marketing efforts at that time were directed toward performing loans in pools based on size, asset quality, asset type, and geographic location. As the workload increased, emphasis was placed on the sale of nonperforming loans, especially those with small individual balances (generally under $10,000). By accelerating the disposition of the small loans, asset specialists could focus on larger loans with higher potential recoveries. From 1986 to 1994, the FDIC sold more than 866,000 loans with a total book value of more than $20 billion.

The FDIC used in-house staff to evaluate, package, and market loan portfolios. The RTC, in contrast, had a unique mission, a relatively short life, and was a taxpayer-funded agency. As such, the RTC was directed by FIRREA to use the private sector whenever it was deemed to be cost-effective. By 1990, the RTC predominantly contracted with private-sector firms to perform all phases of selling those loan portfolios, which included evaluating, packaging, and marketing the portfolios. Using experienced private-sector firms also relieved the RTC of the necessity to hire and train thousands of employees.

One similarity the agencies shared was that both the FDIC and the RTC stratified loan portfolios into pools based on such criteria as geographic area, asset type, asset quality, and asset maturity. Both agencies provided representations and warranties although the FDIC's were more limited than the RTC's.

The RTC adopted the use of seller financing as an additional tool for portfolio sales. Seller financing developed because most of the RTC's assets were secured by real estate mortgages and their disposition was hampered by a nationwide decline in real estate markets.

21. For further information, see Chapter 13, Auctions and Sealed Bids.

Until the 1980s, FDIC auctions had been used to sell real estate and assets such as equipment and automobiles. In the late 1980s, the FDIC expanded the scope of its auctions to include pools of performing and nonperforming loans, as well as loans previously charged off by failed institutions. In August 1987, the FDIC conducted its first open outcry loan auction that offered pools of loans that had been charged off by banks prior to their failure; it conducted six more through June 1995. Although the FDIC experimented with loan auctions, it primarily continued to sell its loans through the sealed bid process.

In part because of its relatively short lifespan, the RTC adopted an auction policy that was more aggressive than the FDIC and conducted 12 regional loan auctions from June 1991 to December 1992. As an outgrowth of this, the RTC established the National Loan Auction Program in September 1992 to provide a common forum for the RTC field offices to market their hard-to-sell loans. Altogether, the RTC conducted eight national loan auctions, with the last one taking place in December 1995.

The RTC's loan auction experience showed that (1) loan auctions were cost-effective when the asset inventory was above a certain level; (2) small regional auctions were as effective as large-scale national auctions; (3) reserve pricing was critical for the sale of difficult, more complex products as a means to guide the market value; and (4) reserve pricing was not needed for performing loans because the bidders could easily establish a market price for those assets.

Real Estate Sales. The FDIC began holding real estate auctions periodically in the late 1980s to dispose of large inventories of smaller, distressed, and labor-intensive real estate properties, such as condominiums and vacant lots. Because of this, real estate auctions connoted the image of a "fire sale" in which the seller was willing to accept heavily discounted prices to liquidate undesirable real estate. Concern regarding a fire sale mentality, or the "dumping" of assets, was prevalent when the RTC was created. As a result, FIRREA included language requiring the RTC to sell real estate for no less than 95 percent of market value, which was defined as appraised value. Consequently, in the early stages of the RTC's existence, real estate auctions were prohibited for fear that they would aggravate already distressed markets and damage the financial standing of banks and thrifts that were heavily invested in real estate markets.

By the late 1980s and early 1990s, it became more acceptable to purchase all types of real estate at auctions, not just distressed properties. This led to the FDIC and the RTC initiating a number of large-scale national auctions as they saw their inventories grow with larger real estate properties. The FDIC coordinated the first nationwide auction of large real estate holdings in March 1989 and held the first of its three national satellite real estate auctions for 178 commercial properties from 23 states in December 1991. As inventory levels fell and asset sizes no longer justified nationwide initiatives, the FDIC suspended the use of national auctions after 1993 and instead relied principally on smaller, regional sales approaches.

The RTC's real estate inventory was more than $18 billion by 1990. Congress raised concerns about the slow pace of asset sales, the carrying costs of inventory, difficulties in managing large numbers of assets, and the continuing decline in real estate prices. FIRREA was amended and, in March 1991, the RTC responded to the mandates of FIRREA by approving a new pricing policy for all real estate sales and authorized the use of auctions to sell real estate. Through its national sales office, the RTC planned, coordinated, and executed real estate sales, including the sale of many real estate pools worth more than $100 million.

An alternative to auctions was the sealed bid asset disposition. The FDIC had historically used the sealed bid method for owned real estate sales, believing it to be quicker and more profitable than auctions. Unlike bulk sales or auctions, sealed bid events were almost always single asset sales until the early 1990s. The RTC also made regular use of sealed bids and operated under procedures similar to those of the FDIC. Generally, sealed bid sales satisfied agency requirements for broad marketing and competitive bidding. The process also facilitated a faster sale, which was especially helpful for properties that were experiencing significant negative cash flows or holding costs.

Asset Management Contractors

During the banking crisis, the FDIC used 14 asset management contracts to liquidate assets with a book value of over $33 billion, which was more than 45 percent of the post-resolution assets the FDIC retained for liquidation. Based on the experiences of the FDIC and the congressional goal of using private-sector resources whenever possible, the RTC started operations with the intent to fully use asset management and disposition contractors to complete its mission. The RTC issued 199 Standard Asset Management and Disposition Agreements (SAMDA) to 91 contractors, from 1991 to 1993, covering assets with a book value of $48.5 billion.[22]

The FDIC first began using contractors to manage and dispose of distressed assets in 1984 with the resolution of Continental Illinois National Bank and Trust Company. As part of the Continental OBA transaction, the FDIC acquired problem assets with an adjusted book value of $3.5 billion. Continental established a special 250-employee unit, known as the FDIC Asset Administration (FAA) unit, within the bank to service those assets. Except for having indemnification authority, the FAA had full delegated authority to manage and dispose of problem assets. The FDIC reimbursed the FAA on a "cost-plus" basis, which meant that the FAA received the cost of its expenses plus incentive compensation based on a tiered scale of net collections.

The next large failure where asset management contractors were necessary occurred in Oklahoma City, Oklahoma, in 1986. Asset management contractors were not used again, though, until 1988 when the FDIC began receiving a torrent of failed bank assets. It began issuing contracts designed for asset pools with a book value of greater than $1 billion called Asset Liquidation Agreements (ALA). The FDIC issued 10 contracts for

22. For additional information, see Chapter 14, Asset Management Contracting.

large banks that failed between 1988 and 1992. The average duration of an ALA contract was four years and five months. Like the Continental contract, all of these large bank contracts had a cost-plus feature where the FDIC reimbursed the contractor for the cost of all operating expenses, including all asset-related expenses, overhead, salaries, and employee benefits and, in addition, paid the contractor an incentive fee.

The process used by the FDIC regarding outside contractors evolved over time. The earlier contracts were negotiated between the FDIC and an asset management organization affiliated with the bank acquiring the deposit franchise of the failed bank. Later, ALAs evolved into competitively bid contracts between the FDIC and private sector contractors who did not have affiliations with the acquiring bank. In the first three ALA contracts, the bank that acquired the deposit franchise also owned and held title to the assets, and the FDIC basically covered the losses to the acquiring bank by paying the difference between each asset's book value and the proceeds obtained on its disposition. With the fourth and subsequent ALA contracts, the assets were owned by the FDIC. That led to a reduced funding cost as the FDIC had cheaper sources of funds than the acquirer did. As additional ALA contracts were established, the FDIC was able to change portions of the ALA structure to improve the model from the experience it gained from previous contracts. Primarily, the changes that were made to the standard ALA contract refined the way incentive fees were calculated to increase the quality of the contractor's performance.

The FDIC provided between 5 and 10 employees to oversee each ALA contract on-site at the contractor's facilities. Under delegated authority, the contractor had day-to-day control of the management of the assets, and an oversight committee composed of two senior FDIC employees and one contractor employee generally had unlimited delegated authority to jointly approve all actions related to larger asset disposition. The oversight committee approved the asset management and disposition procedures prepared by the contractor, the contractor's annual audit plan, budget, business plans, staffing levels, and salary structure, and monitored the contractor's expenses, collections, and goal achievement.

Meanwhile, the RTC had to determine how it would manage its inherited portfolio of distressed thrift assets. It designed contracts for managing and disposing of real estate and nonperforming loan portfolios that were greater than $50 million. The RTC issued the first of its 199 SAMDAs in August 1990. The average term of a SAMDA contract was three years and three months. The contract mandated that the contractors competitively bid and subcontract 12 specified asset management and disposition activities to other firms; those expenses were reimbursed to the SAMDA contractor by the RTC. The smaller size of the SAMDA contract and the subcontracting requirements of the contract allowed the RTC to meet its goal of using more of minority- and women-owned businesses firms.[23]

23. FIRREA in 1989 and RTCRRIA in 1991 mandated that the RTC promote the use of minority- and women-owned businesses (MWOB) as contractors.

The total compensation structure of the SAMDAs consisted of three components: a management fee, a disposition fee, and an incentive fee. The RTC competitively bid the earlier SAMDA contracts to private-sector firms that would submit their qualifications and bids for the management fee and disposition fee. The management fee was paid monthly and was based on the remaining value of the assets under contract. When the contractor disposed of an asset, a disposition fee was earned. Further incentive fees could be earned if the asset was disposed of within a specified time period. Disposition fees were subject to a holdback provision designed to motivate contractors from having assets with high carrying costs remaining on the contract's expiration. Because of a change in the RTC's sales policy toward the promotion of portfolio sales coordinated by RTC staff, the Standard Asset Management Amendment (SAMA) provision was introduced in January 1992 that amended most of the existing contracts by eliminating the collection of the disposition fee by the contractors.

At about the same time, in 1992, that the RTC was adding SAMAs to their contracts, the FDIC developed another type of asset management and disposition agreement, the Regional Asset Liquidation Agreement (RALA). Four RALA contracts, each of which contained asset pools of less than $500 million in book value, were issued to private-sector contractors from November 1992 to June 1993. These four contracts covered assets totaling $1.2 billion in book value with an average term of three years and one month. The RALA contract contained provisions for the payment of a management fee, a disposition fee, and an incentive fee and, most importantly, reimbursed the contractor only for defined asset-related reimbursable expenses, which was effective in controlling costs.

The RALA management fee was based on the estimated gross collections to be received from the assets under management. Unlike the SAMDAs where the RTC allowed contractors to bid the management fee, the RALAs had a fixed management fee rate that was applied to the asset portfolio's estimated gross collection value. The disposition fee schedule, however, could be altered as part of the bidding process; this schedule was based on projected recoveries to be achieved from the entire asset portfolio. The FDIC's estimate of the portfolio's gross collection value also was subject to adjustments from bids. The attainment of specific asset disposition goals within defined time periods served as the basis for the incentive fee. On average, contractors earned 43 percent of their revenue from management fees, 17 percent from disposition fees, and 40 percent from incentive fees. Competition from the bidding process resulted in lower costs than expected.

Table I.1-6 summarizes the financial performance of each program.

Each of the three contracting programs had its own mix of asset types, unique contractual requirements, and distinct operational environment, making the ability to draw direct comparisons among the programs impossible. Some trends are, however, worth noting as each agency revised previous agreements. With respect to compensation, although cost-plus was a feature of the earliest agreements, the agencies generally did not use that compensation method in later contracts, believing that costs could be

Table I.1-6

Summary of Contractor Financial Performance Inception Through December 31, 1996

($ in Millions)

	ALAs	RALAs	SAMDAs	Totals
Number of Assets	84,610	2,455	100,344	187,409
Book Value of Assets in Program:				
Performing Loans	$4,091	$440	$0	$4,531
Nonperforming Loans	19,900	760	26,937	47,597
Owned Real Estate	4,800	0	19,031	23,831
Other Assets	3,200	10	2,509	5,719
Total	$31,991	$1,210	$48,477	$81,678
Book Value Reductions	$30,484	$1,156	$46,425	$78,065
Gross Collections	$22,189	$794	$23,293†	$46,276
Expenses:				
Management Fees	0	17	400	417
Disposition/Incentive Fees	532	19	300	851
Reimbursable Expenses	2,914	15	3,739	6,668
Total Expenses	$3,446	$51	$4,439	$7,936
Net Collections	$18,743	$743	$18,854†	$38,340
NPV of Net Collections*	$16,432	$692	$17,369†	$34,493
Ratios (%):				
Gross Collections/Book Value Reductions	72.8	68.7	50.2	59.3
Total Fees/Gross Collections	2.4	4.5	3.0	2.7
Reimbursed Expenses/Gross Collections	13.1	1.9	16.1	14.4
Total Expenses/Gross Collections	15.5	6.4	19.1	17.1
Net Collections/Book Value Reductions	61.5	64.3	40.6†	49.1
NPV of Net Collections/Book Value Reductions	53.9	59.9	37.4†	44.2

* The net present value calculations (NPV) used the average one-year U. S. Treasury constant maturity rate during the term of the contracts and assumed that net collections were received evenly during the term of the contract.

† Collections exclude all loan payments made prior to 1993. In addition, collections for all assets withdrawn for sale by the RTC were imputed at the lesser of 90 percent of the asset's estimated recovery value (ERV) or its derived investment value (DIV).

Source: ALA and RALA data are from the FDIC Division of Resolutions and Receiverships financial performance report dated June 30, 1996. SAMDA data are from the RTC Asset Management System as of December 31, 1996.

controlled more effectively in other ways. Also, in later agreements, disposition and incentive fees were designed to generate a greater proportion of a contractor's income than in earlier contracts. In addition to compensation methods, other aspects changed as well. The manner in which the contracts were bid changed from negotiated contracts with the acquiring bank to competitive bidding among firms having asset management and disposition expertise.

In summary, neither the FDIC nor the RTC could have managed the volume of assets that came under their custodianship without the use of asset management and disposition contractors. The FDIC and the RTC did not have sufficient staff to manage the huge volume of assets in-house, nor did they have the time required to hire and train them. Through the agreements, the contractors managed and disposed of more than 187,000 assets having a book value totaling $78 billion. Notably, some of these assets were the most complex assets within the FDIC and the RTC inventories. When a manageable level of distressed assets was reached, the contracts either expired under their terms or were terminated, and the agencies moved the remaining assets back in-house to be managed by FDIC and RTC personnel.

Affordable Housing Programs

The RTC and the FDIC affordable housing programs were considered an area in which the nation could glean some social benefit from the financial crisis. The programs' mission was to provide an opportunity for very low- to moderate-income households to realize their dream of home ownership or to improve their standard of living at affordable rent levels. During its approximately five years of operation, the RTC provided 109,141 affordable housing units, worth more than $2 billion, to very low-, low-, and moderate-income households, as well as to nonprofit organizations and public agencies.[24] In total, the RTC sold 81,156 units of multi-family properties and 27,985 units of single-family properties to lower-income families or sold the properties for their benefit.

The RTC developed many strategies for marketing affordable housing. The RTC provided seller financing for 25 percent of single-family and 33 percent of multi-family properties that it sold. Retaining grass-roots technical advisors to assist the buyers and providing repair funding for the properties were two other key aspects of the program.

Because of the large inventory of assets with nominal value, the RTC also developed a policy to donate such properties to a nonprofit organization or public agency at no cost, provided that the assets would be conveyed for the public good, such as for low-income, single- and multi-family housing, homeless shelters, and day care facilities for children of low- and moderate-income families. More than 1,000 single-family and 73 multi-family assets were donated.

24. For further information, see Chapter 15, Affordable Housing Programs.

Although modeled after the RTC program, the FDIC AHP was much smaller in scope. The FDIC provided affordable housing to 2,933 low-income families. A primary difference between the FDIC and the RTC affordable housing programs was their source of funding. Because the FDIC does not use public funds for its operations (its funds come from the premiums it charges to banks for insurance), it required a separate federal appropriation for an affordable housing program. It first received funding for the AHP in fiscal year 1993. The FDIC's program subsidies were operative only insofar as congressionally appropriated funds were available. In contrast, the RTC's program operated with general funds available to the RTC and was not dependent on a specific appropriation.

During the first and second years of the FDIC AHP, the appropriated funds were not sufficient to discount all of the properties that would have been eligible for the program. The annual appropriation legislation allowed the FDIC to modify, at its sole discretion, the statutory requirements so that the available money could be put to the most efficient and beneficial use. That discretion enabled the FDIC to concentrate its efforts on single-family properties where the funding requirements were more modest. Also, discretionary language allowed the FDIC to be more creative in the way it provided discounts, which led to the FDIC's providing credits or grants on properties that could be used toward closing costs or down payments in lieu of straight discounts. The AHP placed 2,400 single-family units with low- to moderate-income families and sold 18 multi-family properties, which included 533 units.

In response to a requirement of the Completion Act, the FDIC and the RTC ratified a plan to merge the affordable housing programs in April 1994. The plan was beneficial as it allowed the FDIC and the RTC to market certain FDIC-owned multi-family properties (to which the FDIC had given a lower priority due to funding restrictions) under the RTC direct sale program.

The FDIC's public funding continued from 1993 for a three-year period on a very limited basis, but it was eliminated at the end of fiscal 1995. Because of a stipulation in FDICIA, the FDIC has to continue to maintain a non-subsidized affordable housing program.

Although the RTC and the FDIC accomplished their goal of providing affordable housing to lower-income families, taxpayer funds were used to subsidize the program. While the FDIC spent the $15.7 million in appropriated funds to run its affordable housing program, the RTC's true costs will never be known because it did not keep an accounting of Affordable Housing Disposition Program (AHDP) costs separate from its other expenses. It is estimated that, on a conservative basis, the RTC's additional asset disposition costs due to the AHDP were in the range of $135 million.

In summary, although the volume of assets handled within the affordable housing programs were relatively minor compared to the total assets sold by both corporations (less than one-half of one percent of total assets liquidated), the programs were viewed as significant. Their most important contribution was that they provided many lower-income families the opportunity to live in decent, affordable housing. Even though there was a monetary cost associated with these programs, the short- and long-term benefits for the participants were significant.

Securitizations

The RTC and, to a much lesser extent, the FDIC successfully used the vehicle of securitization to dispose of a sizeable portion of their large performing mortgage loan portfolios.[25] In August 1990, the mortgage loan inventory of the RTC was estimated to be more than $34 billion. After a disappointing performance in establishing a bulk sales program for such loans, the RTC explored new ways to successfully liquidate its loan portfolio. The mortgage-backed securities market was already well established by two government-sponsored entities, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These entities purchased loans with specific characteristics from mortgage originators and packaged such loans into securities. Although the RTC was able to liquidate a portion of its mortgages in Fannie Mae and Freddie Mac swaps, the majority of its mortgages did not comply with the standards set by those agencies.

Because the size of its nonconforming loan portfolio was so large, the RTC instituted its own private securitization program in December 1990.[26] The loans in this program had characteristics that detracted from their marketability, such as documentation inaccuracies, servicing problems, and late payments. Although the RTC securitization program initially included residential mortgage loans, it was expanded to include other types of loans that previously had not been securitized, such as commercial mortgages, multi-family properties, and consumer loans. (See table I.1-7.)

The RTC originally wanted their securitizations to have a full faith and credit guarantee of the United States government to maximize the number of investors for the offerings. With a direct government guarantee, RTC securities would have had a zero-risk weight similar to the risk weight of Government National Mortgage Association (Ginnie Mae) securities. The RTC Oversight Board did not, however, support a full faith and credit guarantee. The RTC was a temporary federal agency, and the government would retain all of the risk. The U.S. Department of the Treasury also was concerned that issuing a new security with such a guarantee would compete with contemporary Treasury issues. As a result, the RTC did not use a government guarantee to enhance the credit of RTC securities. Instead, the RTC decided to use cash reserves and other methods to provide credit support. Using these methods, it issued publicly

25. Securitization is the process by which assets with generally predictable cash flows and similar features are packaged into interest-bearing securities with marketable investment characteristics. Securitized assets have been created using diverse types of collateral, including home mortgages, commercial mortgages, mobile home loans, leases, and installment contracts on personal property.

26. For additional information, see Chapter 16, Securitizations.

Table I.1-7

RTC & FDIC Securitizations
As of June 30, 1997
($ in Millions)

	Bond Issues			Number of Loans			Credit Reserves		
Type and Number of Transactions	Original	As of June 30, 1997	Percent Decrease	Original	As of June 30, 1997	Percent Decrease	Original	As of June 30, 1997	Percent Decrease
Single-Family (41)	$24,351.50	$7,774.20	68.1	399,946	168,044	58.0	$3,253.60	$2,124.90	34.7
Multi-Family (11)	4,472.20	2,158.40	51.7	8,385	3,198	61.9	1,283.10	732.50	42.9
Commercial (18)	13,931.50	5,157.10	63.0	33,870	15,850	53.2	3,596.00	2,840.20	21.0
Mobile Home (3)	615.90	90.60	85.3	39,987	16,377	59.0	103.70	69.40	33.2
Home Equity (1)	311.49	0.00	100.0	17,600	0.00	100.0	39.40	0.00	100.0
Totals (74)	**$43,682.60**	**$15,180.30**	**65.2%**	**499,788**	**203,469**	**59.4%**	**$8,275.80**	**$5,767.00**	**30.3%**

Source: FDIC Division of Resolutions and Receiverships.

rated mortgage-backed securities for which the senior securities were rated in the two highest rating categories by at least two national credit rating agencies.

The RTC is credited with developing the market for securities backed by "non-traditional" assets, most notably commercial mortgage loans. (As a point of reference, the securitized commercial mortgage loan market has grown from $6 billion in 1990 to more than $80 billion in 1997.) Commercial securitizations were an efficient way for the RTC to transfer large portfolios of real estate into the private sector by providing a consistent marketing approach to sell these assets at competitive market prices.

The FDIC securitizations, although based on the RTC's program, were different in one major respect: the FDIC provided a limited guarantee as a mechanism for credit enhancement for which in return it would receive the excess interest after payment of the securities' principal and interest. The FDIC completed its first securitization transaction in August 1994 for $762 million of performing commercial real estate mortgage loans from 197 failed institutions. A second securitization followed in December 1996 for $723 million in commercial mortgage loans from 180 failed institutions. Both issuances were considered successful.

From 1991 through December 1996, 72 RTC and 2 FDIC securitization transactions were consummated, backed by more than $43.7 billion in book value of almost

500,000 conservatorship and receivership mortgage loans. Of the RTC's asset portfolio, more than $42 billion, or more than 10 percent, of its total assets were resolved through securitizations. The RTC's securitization program was considered particularly successful not only because of the amount of assets that were liquidated through it, but also because of the innovative methods the RTC used, given its large portfolio of nonconforming loans, to forge new markets through which it accomplished its disposition goals. Although the RTC used securitizations more than the FDIC, both agencies found the approach to be effective when liquidating their large inventory of mortgage loans. Furthermore, outside investors have found worth in these securities, which are actively traded in secondary markets all over the world.

Equity Partnerships

One of the more innovative methods the RTC used for asset disposition was the equity partnership. In an RTC equity partnership, the RTC sold nonperforming assets acquired from failed thrifts to a joint venture between a private sector firm and the RTC. The private investor acted as general partner and controlled the management and disposition of the partnership's assets. The RTC's ongoing role was limited and generally passive, restricted to having an "equity" interest in the assets that it had sold. The RTC created equity partnerships in an effort to obtain greater present value recoveries from troubled assets by capturing the expertise and efficiencies of the private sector and reserving some upside potential from the recovery of depressed markets.[27]

Although the concept of having the RTC hold a residual interest in sold assets was introduced in its first strategic plan in 1989, the RTC did not create an equity partnership until the fall of 1992. By that time, the RTC had tried several different approaches to dispose of nonperforming assets, most notably using private asset management contractors to manage and dispose of assets both individually and by multi-asset sealed bid sales. Each of these approaches had benefits and drawbacks. Assets disposed of through the contracting program appeared to have acceptable recoveries, but administering the program was burdensome and the pace of asset disposition slow. The RTC's multi-asset sales conveyed large volumes of nonperforming loans in a timely manner, but anecdotal evidence suggested that the purchasers were able to obtain high returns by quickly restructuring or settling the loans. The partnership structure provided a vehicle for obtaining the desired features of both programs.

The RTC created 72 partnerships with a total asset book value of about $21.4 billion. Seven different partnership structures were developed, each designed for specific asset types and investor markets. The RTC contributed asset pools as its equity capital and arranged for financing of the partnership, providing a leveraged return to the investor. The general partner invested both equity capital and asset management services.

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27. For additional information, see, Chapter 17, Partnership Programs.

Table I.1-8

General Characteristics of the Equity Partnership Types

	Program Inception	Number of Partner-ships	Bonds?/ Bond Holder	Types of Underlying Assets	Target Investor/ Legal Structure	LP/GP* Ownership Percentage
N Series	Dec. 1992	6	Yes/ Institutional investors via open market	Commercial and multi-family non-performing loans	Large investors/ Trust	51/49
MIFs	Jan. 1993	2	No, but bond equivalent/ Held by RTC	Commercial and multi-family non-performing loans, REO†	Large institutional investors/ Partnership	25-50/ 50-75
Land Funds	July 1993	12	No	Undeveloped and partially developed land (REO and non-performing loans)	Small investors/ Partnership	60-75/ 25-40
S Series	Sept. 1993	9	Yes/Held by a trustee for the RTC	Commercial and multi-family non-performing loans	Small investors/ Trust	51/49
JDCs	Dec. 1993	30	No	JDCs and small balance assets (SBAs)	Investors with collection experience/ Partnership	‡
SN Series	Aug. 1995	5	Yes/Held by a trustee for the RTC	Commercial non-performing loans	Large and small investors/Trust	51/49
NP Series	Aug. 1995	8	Yes/Held by a trustee for the RTC	Nonperforming land loans and land REO, unsecured loans or loans secured by non–real estate collateral (such as business loans), nonperforming commercial real estate and REO (commercial and multi-family)	Small investors/ Trust	50-70/ 30-50

* LP is limited partnership; GP is general partner.

† REO is real estate owned.

‡ The LP contributed 1 percent of the book value for JDCs and 20 percent of the book value for SBAs; the GP contributed 0.0101 percent of the book value for JDCs and 0.20 percent of the book value for SBAs.

Source: FDIC Division of Resolutions and Receiverships.

The financing terms required that cash proceeds generated from the liquidation of assets be applied first to retirement of the debt (usually bonds held by the RTC). After the debt was paid in full, the partners generally split the remaining proceeds according to the percentage of ownership each respective partner held. Table I.1-8 outlines the general characteristics of the RTC equity partnerships.

The largest of the seven types of equity partnerships set up by the RTC was the Judgements, Deficiencies, and Charge-offs (JDC) Program. The JDC Equity Partnership Program established 30 partnerships containing 137,000 assets with a book value of $12.4 billion. The assets the RTC contributed generally were legally impaired or were unsecured and of poor quality, so typically the general partner was a firm with collection experience.

By participating in the JDC partnerships, the RTC was able to have a large volume of low quality, small balance assets processed when it realistically could not have staffed such an effort, but yet it could share in the results of having profit-oriented firms cull the assets for any substantial recoveries that might have otherwise been overlooked.

The FDIC became a limited partner in two partnerships, known as the Asset Management and Disposition Agreements or AMDA partnerships, which held assets with a book value of approximately $3.7 billion. Unlike the equity partnerships, which the RTC created to dispose of assets, the AMDA agreements were vehicles used to restructure certain FSLIC assistance agreements. Once created, however, the AMDA partnerships operated similarly to the equity partnerships, with a general partner controlling the management and disposition of the partnership's assets and the FDIC serving as limited partner. Each was established to operate for five years and held a variety of asset types, although most were nonperforming.

Professional Liability Claims

Professional misfeasance and malfeasance were notable factors in the enormous losses from the financial institution crisis of the 1980s. The professional liability programs of the FDIC and the RTC reviewed these bank and thrift failures and sifted through thousands of potential claims relating to conduct by former directors, officers, attorneys, accountants, appraisers, brokers, and other professionals formerly affiliated with these failed banks and thrifts. This effort contributed more than $5 billion in cash recoveries to the FDIC and the RTC receiverships.[28]

Litigation Management

As the asset levels increased, the agencies also had to address many legal issues. The FDIC and the RTC increasingly turned to outside counsel to effectively manage the

28. For further information, see Chapter 11, Professional Liability Claims.

tremendous volume of legal matters related to the FDIC's role as receiver and the RTC's roles of conservator and receiver.[29] The legal work encompassed areas such as foreclosure, loan workout, bankruptcy, contract disputes, asset sales, collection of notes and guarantees, state and federal tax issues, pension funds, environmental issues relating to the institution's property, torts, and shareholder suits. The use of outside counsel peaked in 1991 when the combined FDIC and RTC direct and indirect payments to outside counsel reached $701 million.

Asset Disposition Summary

In summary, because of the enormous amount of assets that flooded the FDIC and the RTC, the agencies had to be creative, yet responsible, in how they determined their policies regarding the handling and resolution of assets. While the FDIC strove to pass on as many assets as possible to the acquirer at resolution, the RTC focused on the disposition of assets in the conservatorship and receivership periods. Both agencies effectively used auctions and sealed bids to move as many assets as quickly as possible into the private sector. The RTC and the FDIC also improved other standard asset disposition methods and developed many innovations. For example, the agencies created new markets through the use of securitization, particularly for commercial mortgages, and equity partnerships enabled the agencies to transfer large amounts of assets into the private sector while obtaining potentially greater recoveries. All of these strategies enabled the agencies to efficiently dispose of the majority of the failed institutions' assets for which they became responsible during the crisis period.

Methods for Handling Liabilities

Simply put, a bank fails when its liabilities exceed the value of its assets. When this occurs, the FDIC as receiver needs to determine which of the creditors of the failed bank should be paid from the proceeds of the sale or settlement of its assets. Until 1993, the FDIC's first priority for paying unsecured claims against the failed national bank's estate was the administrative claims of the receiver followed by the deposit liabilities and general creditor claims; if any proceeds remained, payments were made in turn to the subordinated debtholders, the Internal Revenue Service for unpaid federal income taxes and, finally, the shareholders. The FSLIC process for distribution was similar to this although there were a few more classes of creditors identified. For failed state chartered institutions, each individual state was responsible for determining the order of payment, although usually the only main difference was that some states gave priority to all depositors claims (after administrative costs) over the other general creditors. The National

29. For further information, see Chapter 18, The FDIC's Use of Outside Counsel.

Bank Act of 1864 established the priority of payment on unsecured creditors for national bank receiverships. The various claims priorities were unified on August 10, 1993, when the National Depositor Preference (NDP) Amendment was passed. This law standardized the asset distribution process for all receiverships regardless of charter. Claims now are paid in order of administrative expenses followed by depositors, other general creditors, subordinated debtholders, and those in the last claimant category, the shareholders.

A failed bank receivership will have many types of creditors laying claim to the assets. One type of creditor that is resolved early in the receivership is the secured depositor. Generally, these depositors are municipalities, school districts, or state agencies that by law must have their deposits secured in order for a bank to hold them. This is accomplished by the depository institution pledging sufficient securities to cover any deposit funds that would otherwise be uninsured in the event of a bank failure.

The largest liability of any failed institution is usually its insured deposits. When a financial institution fails, the FDIC, in its role as insurer, pays depositors their insured portion, then "steps into the shoes" of the depositors as claimant and files its subrogated claim against the receivership estate. Therefore, the FDIC is paid in the class that the depositors would otherwise occupy.

The FDIC is committed to providing insured depositors with their funds as quickly as possible after a bank fails. Since the start of FDIC deposit insurance on January 1, 1934, not one depositor has lost a penny of insured funds as a result of a failure. Until the early 1980s, the payment process was burdensome for the FDIC to complete. In the mid-1980s, the FDIC computerized the payment processes used to identify the insured depositors to the point where, in most instances, the insured depositors have the use of their funds the day following the bank failure. Depositors also can have their checks mailed to them, which eliminates the need to stand in line at the failed bank.

Until the early 1980s, losses to uninsured depositors were relatively small. All failed banks with deposits totaling more than $100 million had been handled with P&A transactions that protected uninsured depositors. In the smaller institutions, the amount of uninsured funds normally was very little. As the bank failures grew in average size, so too did the number and dollar amount of the uninsured accounts. Large banks held deposit accounts from commercial businesses, other banks, and high profile accounts such as those from large churches and local governments. With the failure of the Penn Square Bank, N.A. (Penn Square), Oklahoma City, Oklahoma, in 1982, the exposure of many financial institutions to a serious loss of liquidity was brought sharply into focus.

In 1983, the insured deposit transfer resolution was developed by the FDIC to alleviate some of the problems insured depositors encountered. The IDT process transferred the insured accounts to an open institution for administration. IDTs permitted the depositors of a failed institution to make an orderly and convenient transfer to an open institution and the acquiring institution gained new customers.

To reduce the hardship on uninsured depositors, in 1984 the FDIC began making advance dividend payments soon after a bank's closing. The advance dividend percentage is based on the estimated recovery value of the failed bank's assets. Advance dividends provide uninsured depositors with an opportunity to realize an earlier return on the uninsured portion of their deposits without eliminating the incentive for large depositors to exercise market discipline. If the FDIC's actual collections on the assets of the failed institutions exceeded the advance payments and administrative expenses of the receivership, the uninsured depositors and other creditors received additional payments on their claims. The FDIC did not pay advance dividends when the value of the failed institution's assets could not be reasonably determined at the closing.

The incentive for depositors to exercise discipline was increased with the passage of FDICIA in 1991, which required the FDIC to select the resolution method that is the least costly to the insurance fund. This places transactions with bids on uninsured deposits at a pricing disadvantage.

The category of other general or senior liabilities of a failed institution includes claims from vendors, suppliers, and contractors of the failed institution; claims arising from repudiated contracts; claims arising from employee obligations; tax claims; and claims asserting damages as a result of business decisions of the failed institution. In 1993, the National Depositor Preference Amendment lowered claimants in this category to a priority level below that of the deposit liabilities, thereby significantly reducing any potential recovery on these claims. Before NDP legislation, many banks and thrift receiverships paid general creditor claims on par with deposits.

Subordinated debtholders are allowed claims on receivership assets only after all claims with a higher priority have been satisfied. Any liability of the insured depository for a cross guarantee assessment would receive distributions after subordinated debtholders, but before distributions were made to shareholders.

Of the claimants, stockholders have the lowest priority and rarely if ever receive a dividend. Even in the case of an OBA transaction, all of its depositors and creditors were protected, but the shareholders' position was significantly diluted.[30] For P&A and deposit payoff transactions, the shareholders do not receive any payment unless all other creditors' claims are paid in full. From 1986 through 1994, the FDIC made distributions to stockholders in only 16 receiverships.

With their low priority status, subordinated debtholders and shareholders should provide the most discipline for financial institutions. This is especially true for individuals that are directors of the institution. In addition to their financial investment risk, they have some individual fiduciary liability if the institution fails because of some negligent acts by the board of directors.

In summary, the manner in which the FDIC handles liabilities of failed financial institutions and administers claims against their receiverships is an important part of its responsibility to lessen the economic effects of the failure of those financial institutions. The claims process has evolved into one that is predictable while meeting statutory requirements. As such, this process ensures that creditors are treated in an equitable and timely manner.

30. For further information, see Chapter 5, Open Bank Assistance.

Conclusion

The period between 1980 and 1994 was one of turbulent change for the banking industry, which saw record numbers of bank and thrift failures, the creation and dissolution of the RTC that was specifically designed to handle thrift failures, and new legislation that continually affected the way the FDIC resolved bank failures.

The FDIC's primary objective is to maintain financial stability and public confidence in the banking system. Although severely tested throughout this period, public confidence in deposit insurance never faltered. No depositor lost a penny on federally insured deposits. One of the main differences between the financial crises of the early 1930s and the 1980s was that in the latter period, the insured depositors trusted that they would not be harmed in the event of a bank failure. The FDIC and the RTC were able to gain control, liquidate, and resolve large numbers of financial institution failures without causing disruption and panic in the banking system.

The FDIC and the RTC also sought to soften the effect that the banking crisis had on the economy and to contribute to regional, as well as national, economic recovery. Their results in this area were favorable, but not without criticism. On the positive side, deposit insurance provided immediate liquidity to depositors whenever their bank failed and limited the negative effects of the failure on the local communities. In the majority of the failures, both the RTC and the FDIC had success in locating an acquiring institution to provide a continuation of banking operations. This also softened the effect of the bank failure on the community. On the negative side, however, the handling of loan customers during both the agriculture crisis and the distressed economic situation in New England was criticized.

The FDIC and the RTC met their objectives in a myriad of ways. Whenever a bank failed, the FDIC's primary focus was to ensure that the depositors received the use of their insured funds as soon as possible, which throughout the crisis was almost immediately after a bank failed. This eliminated any doubts or negative publicity about the deposit insurance system. Another method used to reduce the effects of a bank failure was the careful selection of the transaction type to be used to resolve the situation. A majority of the resolutions of both the FDIC and the RTC was completed by using a P&A transaction rather than a deposit payoff or an insured deposit transfer. The majority of those transactions protected all depositors (including those who were uninsured) against any loss. For failed thrifts, even though the FSLIC fund was insolvent, Congress took action to reassure the depositors that their insured funds would be safe.

The Evolution of the Resolution Process

Flexibility and innovation were the keys that enabled the FDIC and the RTC to meet their objectives. As the economy deteriorated and the number and size of the problem banks increased, the FDIC changed its resolution process to balance the needs of the industry with its own practical limitations. For example, when it became apparent that there would be more deposit payoff situations, the FDIC created the insured deposit transfer transaction. That reduced the burden on insured depositors, and the need for them to line up to receive their funds was eliminated.

The FDIC also expanded its resolution options during this period to adjust to the changing times. The original P&A transaction did not transfer many assets with it. If the FDIC had not modified this process, it would have been unable to internally handle the volume of residual assets. As liquidity and workload pressures grew, the FDIC began to consider techniques and incentives to pass more of the failed banks' assets to the acquirer. A law was passed in 1987 to provide the FDIC with bridge bank authority. This provided the FDIC with the flexibility needed to handle large bank failures. To reduce the flow of assets into the FDIC, it introduced the whole bank sale transaction in 1987 and emphasized its selection from 1988 to 1991. In the end, the most dominant features of the FDIC's resolutions process were the efforts that were made, and the results achieved, in moving assets back to the private sector and the fact that all depositors generally were protected against any loss.

The FDIC created loss sharing transactions in 1991 to reduce the acquirer's concerns about the quality of failed bank assets and to keep bank assets in the banking system. The RTC increased competition for failed S&Ls by completing branch breakups to cater to the needs of their bidders.

The RTC used conservatorships to take control of a large number of institutions and to begin the process of liquidating their assets before the conservatorships were finally resolved. Because of the lack of funding for the RTC, the assets were in conservatorship an average of 13 months, a much longer period of time than were failed bank assets in bridge banks. This altered the RTC's original plan of duplicating the FDIC resolution process. Proceeds from those asset sales reduced the RTC's immediate funding problems and allowed the RTC to continue their liquidation efforts even without the availability of loss funding.

The Evolution of Asset Disposition

The ability to adjust and create new methods to adapt to the ever-changing marketplace was instrumental for both the FDIC and the RTC in accomplishing the task of disposing of assets acquired from failed financial institutions. Generally, the agencies had two basic requirements for asset disposition: (1) to dispose of the assets as soon as possible without upsetting local markets, and (2) to maximize the return to the receiverships. The factors and processes used to decide, for example, when to hold versus when to sell assets or when to litigate versus when to compromise evolved in response to the circumstances of the times.

While the primary FDIC asset disposition strategy was to sell the majority of the failed bank's asset portfolio to the acquiring bank at the time of resolution, the FDIC employed several other resourceful ways to liquidate its ever-increasing volume of assets. In the early 1980s, the FDIC normally used in-house staff to liquidate assets one at a time. Over time, the two agencies employed more sophisticated disposition methods both in-house and through the use of their contractors. Methods such as securitizing asset sales, creating equity partnerships with private-sector firms along with mass marketing methods in bulk sales of loans, auctions, and multiple sealed bid events became the standard. The RTC was especially innovative when implementing an effective affordable housing program, which successfully employed seller financing, close working relationships with local nonprofit firms, and auctions.

The main results of the two agencies in the area of asset disposition were (1) the RTC arranged for the securitization of $42.2 billion in mortgage loans; (2) the RTC developed equity partnerships with private-sector firms to manage the collection of $25 billion in book value of assets; (3) the FDIC and the RTC created asset management programs with outside contractors that serviced $80 billion in distressed asset pools; (4) the FDIC created a secondary market for nonperforming loan sales and sold in excess of 800,000 loans through sealed bid sales; (5) the FDIC piloted national real estate auctions and both the RTC and the FDIC arranged real estate events that sold hundreds of millions of dollars of property at each event; (6) the RTC developed a national Affordable Housing Program and sold more than 100,000 units; and (7) in a life span of slightly over five years, the RTC disposed of more than $400 billion in assets; at its sunset, only $8 billion in assets were transferred to the FDIC.

The Maintenance of Public Trust

Maintaining public trust is a key objective for any federal agency. Professional abuse, especially in the thrift industry, was suspected to be widespread, and the FDIC and the RTC needed to conduct a fair and consistent investigative process of these matters. Professional misconduct was a notable factor that exacerbated the losses from the financial institution crisis, and these parties needed to be held accountable for wrongful conduct. The professional liability programs of the FDIC and the RTC yielded cash collections of more than $5 billion (as of December 1997) and had a positive effect on the awareness of professional standards, which directly benefits the public by promoting discipline among all professionals.

The dramatic growth in the two agencies also increased their vulnerability to inefficiency and ineffectiveness, as well as waste, fraud, abuse, and the misappropriation of assets. As the workload and staffing expanded accordingly and operations grew in complexity, traditional internal control methodologies proved insufficient. The FDIC and the RTC were faced with three areas of high vulnerability: contracting and contract management, information systems, and asset management and disposition. The internal control programs at the FDIC and the RTC were altered to adapt to the radically changing dimensions of their management requirements. In addition, mounting public concern over the financial institution crisis and new laws subjected virtually every aspect of the agencies' activities to outside scrutiny. Ultimately, the financial crisis was resolved by the FDIC and the RTC without serious mismanagement or waste, issues that could have eroded public trust.

Other Key Objectives

Cost-Effectiveness. One objective common to both the FDIC and the RTC was to minimize costs and maximize the net present value return from the disposition of failed banks and thrifts and their assets. The 1,617 banks that failed or required OBA between 1980 and 1994 had $302.6 billion in assets. The FDIC's cost of handling these failed banks was $36.3 billion, or about 12 percent of the banks' assets. The 747 institutions that the RTC resolved from 1989 to 1995 had $402.6 billion in assets. The RTC's cost of handling these assets was $87.5 billion, or 22 percent of the assets. It is difficult to draw any firm conclusions regarding cost because of the large number of variables that affected these results. For example, the agencies had no control over such factors as the condition of the assets at the time of failure, any unrecognized losses in the failed institutions' portfolios, and prevailing economic conditions.

Equitable Treatment. Throughout this period, one objective that the FDIC had difficulty in achieving was equity to all parties throughout the resolution process. A prime example of this was the OBA transaction used to assist Continental. This type of resolution sparked a policy debate about whether certain banks were truly "too big to fail" and whether they were given special treatment not available to smaller institutions. Whether equitable or not, the FDIC felt it had fully considered a number of substantial concerns that justified the manner in which Continental was handled. The FDIC and other regulators had concerns of systemic risk that Continental's potential failure could extend beyond the bank itself. Those risks included a potential liquidity crisis for major banks with significant foreign deposits that could have caused a decrease in foreign investor confidence in U.S. financial institutions, a severe equity blow to the many unaffiliated banks with uninsured correspondent bank accounts at Continental, and a negative effect on financial markets in general. A failure of such magnitude could have caused other bank failures and tied up creditors in bankruptcy for years.

In instances where the FDIC provided assistance to keep a failing bank open or where the FDIC created a bridge bank, critics have sometimes expressed concern that the government had, in fact, "nationalized" the bank and given the assisted bank undue advantage over other banks mainly because of its low cost of funds. This concern, however, is mitigated by the short-term nature of a bridge bank. The effect of any unfair advantage for assisted banks is offset by the covenants that restrict shareholder benefits until after the FDIC's stock interest is redeemed. Stock ownership by the FDIC also worked to reduce the costs of resolution if there was any increase in the value of the stock.

The FDIC and the RTC also were concerned about equal treatment toward failed bank borrowers in the resolution process. In New England this became a topic of discussion because of the extended economic issues that led to a credit crunch in this region.

Borrowers in special asset pools were sometimes hampered in their refinancing efforts by the stigma of being a failed bank customer. The FDIC addressed this by placing such borrowers back into the acquirer's loan portfolio, subject to the FDIC's guarantee to buy back the loans that deteriorated. The creation of the loss share transaction also has addressed this problem by providing for loan customers to remain with the acquiring bank and for any losses to be shared with the FDIC.

Issues Related to Attainment of the Agencies' Objectives

The crisis has shown that there are other issues closely related to the ability of the agencies to reach their objectives. These issues are discussed in more detail below.

Use of the Private Sector. Both the FDIC and the RTC extensively employed the private sector during the crisis years. The FDIC used private-sector firms to manage more than 45 percent of its post-resolution assets during the peak period of 1988 to 1993. Because of its temporary status and as mandated by law, the RTC used private-sector resources whenever possible and used SAMDA contractors to manage hard-to-sell assets. The RTC also made good use of the secondary market to sell its securitized portfolios. In addition, the RTC established partnerships with outside parties to manage and dispose of distressed assets that either had a low present value or could not be securitized.

The FDIC modified its asset management contracts throughout the years, learning as it gathered experience. One of those lessons is that the creation of a successful contract hinges on the proper alignment of the (primarily financial) interests of the asset management firms with those of the FDIC. In addition, minimal interference from the government is important to the private sector to allow it to operate efficiently. Identifiable performance measures also are critical to motivate the contractor effectively. Finally, the contractors should be fair and equitable in all facets of their business dealings.

Competition. For the most part, both the FDIC and the RTC developed resolution and asset sales programs that provided competition to the broadest market of qualified financial institutions and asset buyers. At the beginning, because of the large volume of assets at the RTC, some of its sales were naturally restrictive because the portfolios were too large for most investors. Because of outside pressures, the RTC reduced the size of its portfolios to attract smaller investors; this change, although initially resisted, was of benefit because it increased competition and seemed to bring about better results.

The FDIC and the RTC were innovative in their sales events. The FDIC's national auctions of properties used advanced satellite technology to offer simultaneous auctions to major cities across the country. Buyers no longer needed to travel great distances to attend an event. The RTC also broke new strategic ground by selling assets through a partnership program. This program was unique in that it took product that would not bring an optimal price given the condition of either the asset or the current market and because it created a disposition vehicle that would allow the RTC (and later, the FDIC) to share in the value enhancement resulting from improved real estate markets and a better economy.

Independence. Congress has entrusted the FDIC with complete responsibility for resolving failed federally insured depository institutions and has conferred expansive powers to ensure the efficiency of the process. As receiver and as insurer, the FDIC is not subject to the direction or supervision of any other agency or department of the United States or of any individual state in the operation of the receivership. Those statutory provisions allow the FDIC to exercise its discretion in determining the most effective resolution of a failed institution's assets and liabilities. In exercising that authority, the FDIC is expected to maximize the return on the assets of the failed bank or thrift and to minimize any loss to the deposit insurance fund. The FDIC as receiver is also responsible for liquidating the failed institution's assets and using the proceeds to pay proven creditors.

Market Discipline. When large banks were in jeopardy, the FDIC had in the past protected all depositors from loss, as in the case of Continental and Bank of New England, Boston, Massachusetts. Large banks (with the exception of Penn Square) were resolved either through P&As, bridge banks, or OBA agreements where all depositors were protected.

To preserve financial stability and maintain public confidence in the deposit insurance system, however, a certain amount of market discipline is required. The savings and loan industry is a prime example of what can happen in the absence of such discipline. This situation resulted in the insolvency of the federal insurance fund for savings and loans, the subsequent dissolution of the FSLIC, and the large losses that were ultimately borne by the taxpayer.

Depositors and shareholders can provide a bank with market discipline to operate without taking excessive risks. At the time of failure, management is always removed, and the claims of the shareholders fall behind those of the depositors, the FDIC, and the bank's creditors. Because the shareholders' entire investment is almost always lost, or in the case of some OBAs at least severely diluted, they instill a certain amount of market discipline in the operations of the bank. Often, the larger shareholders are also directors of the bank; if the directors' actions are determined to be grossly negligent, they may become liable for some of the losses that they caused.

The depositors, for the most part, are minimally affected by the bank failures. Insured depositors who are fully protected by the FDIC provide no discipline to the system. In small banks, the uninsured depositors represent such a small portion of the banks' deposits that they do not influence the banks' actions. In addition, in the 1980s when the FDIC chose to complete P&A transactions for the majority (73.5 percent) of its resolutions, depositors had little reason to exercise discipline as all insured and uninsured deposits were protected in those transactions. Also, from 1980 to 1992, the FDIC completed 133 OBA transactions that again protected all depositors. The ability of banks to obtain fully insured brokered deposits lessened the effect of depositor discipline as well.

There were signs, however, that uninsured depositors exercised some discipline during this period. As problems became known, especially at some of the larger troubled institutions, those institutions had to borrow heavily from the Federal Reserve to provide liquidity caused by the withdrawal of funds by their larger depositors.

Since passage of FDICIA, there is more of an incentive for the uninsured depositors and unsecured creditors to exercise deposit discipline. The least cost provision usually causes the uninsured to share in the cost of the resolution. From 1992 to 1995, this has, on average, occurred in 82 percent of the cases. From 1986 to 1991, it took place, on average, only 17 percent of the time.

Funding and Liquidity. To ensure financial stability and public confidence in the banking system, a strong insurance fund is a necessity. The FSLIC was forced to complete transactions that had the least short-term effect on their insurance fund, which had the unfortunate effect of increasing the long-term cost of cleaning up the S&L crisis. Thrifts were viewed at the time to be too costly to resolve. The government appropriations that would have been required were not forthcoming until creation of the RTC. The lack of funding and increased congressional oversight restricted the FSLIC's ability to react quickly to many of the early, pre-FIRREA thrift crisis issues.

The FDIC also had funding and liquidity concerns during the late 1980s and early 1990s. This led, in part, to the FDIC's preference for whole bank sales to preserve liquidity. The lack of whole bank transactions since enactment of FDICIA (which contains the least cost provision) seems to show that whole bank sales were not the most cost-effective alternative. For several large bank failures in the late 1980s, the FDIC selected resolutions in which the assuming bank retained the problem assets to preserve the insurance fund's liquidity. These agreements resulted in the FDIC reimbursing the acquirer at a higher cost of funds than would have been the case if the FDIC had retained ownership of the assets. Another way the FDIC reduced its initial cash outlay was to use puts to induce the acquiring banks to take the assets at failure. Because the acquirers returned the majority of the assets to the FDIC before expiration of the put period, however, this option was significantly limited.

The lack of adequate, consistent funding also affected the way the RTC completed its mission. Because of the high cost associated with resolving the S&L problem and its effect on the U.S. deficit, the RTC often was hampered by delays in obtaining government-approved funding. The RTC had to be selective in choosing which S&L could be resolved and which had to remain in conservatorship. The conservatorships were operated for longer periods of time than would have been necessary if sufficient funds had been available. Because the thrifts' cost of funds was higher than the government's cost of funds, this additional expense had to be added to the final cost of cleaning up the S&L crisis.

Summary. Both the FDIC and the RTC made mistakes as they struggled to find a solution to the challenge of moving billions of dollars of assets properly back into the private sector. Some saw the agencies as too bureaucratic, while others complained that assets were sold too quickly and at below market prices. Nevertheless, the FDIC and the RTC accomplished their objectives. By staying flexible and creative, the FDIC and the RTC maintained the public's confidence while providing stability to the financial marketplace. Their collective experience in managing the crisis has provided the FDIC, as well as the financial industry and other regulators, with invaluable lessons on how the financial marketplace works in times of both adversity and prosperity.

After gathering the necessary information and determining the appropriate resolution structure to be offered, the FDIC begins to confidentially market the failing bank or thrift as widely as possible to encourage competition among bidders.